

# ARTICLES

## ACQUIRING LAND USE RIGHTS IN TODAY'S CHINA: A SNAPSHOT FROM ON THE GROUND

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### ABSTRACT

For the interested observer of contemporary real estate markets, China is the most fascinating place in the world, and the coming years promise to be no less exciting. This Article offers an overview of how a specific segment of the Chinese real estate market—the acquisition of land use rights—operates in practice, from both a legal and business perspective.

I recently interviewed dozens of Chinese and Western experts who are taking part in one of the greatest real estate booms in world history. My conversations with these real estate developers, bankers, government officials, judges, practicing lawyers, consultants, economists, real estate agents, and law and business professors provide acute insights into how China is transforming itself from an economic backwater into a self-styled “socialist market economy.”

The fact that Chinese real estate and business laws are still in an early stage of development, the speed with which the Chinese legal and economic systems are evolving, and the strong cultural tradition of reliance on personal relationships rather than rule-of-law principles all demonstrate why a

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straightforward doctrinal approach would be incomplete and misleading. My goal here is to establish how this particular aspect of Chinese real estate practice is maturing with what appears to be tremendous success against the backdrop of a young legal system.

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## I. INTRODUCTION

The West has become fascinated with China. Journalists marvel at China's ability to maintain double-digit growth year after year while expressing concern about America's rising trade imbalance with this important partner.<sup>1</sup> American consumers enjoy lower and lower prices for Chinese-made goods ranging from textiles to DVD players, while American manufacturers decry the ability of Chinese factories to underprice their few surviving American competitors. Trading partners welcome China into the World Trade Organization while wondering what effect that nation's economic expansion will have on the price and availability of critical commodities, particularly oil.<sup>2</sup>

Not lost in this discussion is the astonishing real estate boom throughout China, especially in its major eastern metropolitan areas.<sup>3</sup> Shanghai, China's key financial center located near the mouth of the Yangtze River, is said to be the home to one-fifth of the world's construction cranes, which local residents refer to as China's national bird.<sup>4</sup> Developers are ordering structural steel at a rate that is causing shortages and price increases around the globe. Shanghai residents speak of little else but their desire to purchase residential apartments as soon as possible, so as not to

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1. See, e.g., Fared Zakaria et al., *Does the Future Belong to China?*, NEWSWEEK, May 9, 2005, at 26 (lead article in issue entitled "Special Report: China's Century" that contains nine stories devoted to China); *How to Make China Even Richer*, THE ECONOMIST, Mar. 25, 2006, at 11 (lead article in issue entitled "Special Issue on China's Reform Tasks: How to make China even richer" that contains eight stories devoted to China).

2. See generally RANDALL PEERENBOOM, CHINA'S LONG MARCH TOWARD RULE OF LAW 492-96 (2002) [hereinafter PEERENBOOM, LONG MARCH] (discussing immediate effects and likely future implications of China's accession to the World Trade Organization, along with continuing reasons for concern); Keith Bradsher & Christopher Pala, *China Ups the Ante in its Bid for Oil*, N.Y. TIMES, Aug. 23, 2005, at C1 ("One of China's state-owned oil companies may still be smarting from its failure to acquire Unocal this summer. But another Chinese oil giant showed on Monday that this country is still snapping up assets to satisfy its hunger for energy."); Jad Mouawad, *Outlook on the Economy: With Oil Prices Off their Peak, Are Supplies Assured?*, N.Y. TIMES, Dec. 5, 2005, at C10 ("In 2004, global oil consumption rose 3.7 percent, . . . a pace that surprised analysts and oil executives. China alone accounted for a third of that growth, its demand for oil up 15 percent.").

3. David Barboza, *China Builds its Dreams, and Some Fear a Bubble*, N.Y. TIMES, Oct. 18, 2005, at A1 ("This year alone, Shanghai will complete towers with more space for living and working than there is in all the office buildings in New York City").

4. Many observers are particularly struck by the prevalence of construction cranes in Shanghai. See, e.g., PAMELA YATSKO, NEW SHANGHAI: THE ROCKY REBIRTH OF CHINA'S LEGENDARY CITY 26 (2001) [hereinafter YATSKO, NEW SHANGHAI] ("Shanghai . . . embarked in 1992 on what has to be one of the biggest building sprees the world has ever seen. From the top of the Hilton Hotel, which in 1995 was still one of the tallest buildings in the city, the horizon yielded more tower cranes in every direction than the eye could count.").

miss out on a bonanza that may not recur in their lifetimes. This is a truly remarkable development in a nation in which all land still is owned by governmental units or agricultural collectives, and the government is firmly controlled by a single political party that remains Communist at least in name.<sup>5</sup>

This Article offers an overview of how a specific segment of the Chinese real estate market—the acquisition of land use rights—operates in practice, from both a legal and business perspective. During the summer of 2005, I interviewed dozens of Chinese and Western experts who are currently taking part in what can be described, without exaggeration, as one of the greatest real estate booms in world history.<sup>6</sup> My conversations with these real estate developers, bankers, government officials, judges, practicing lawyers, real estate consultants, economists, real estate agents, law professors, business professors, law students, and recent homebuyers provide acute insights into a major nation that is quickly transforming itself from an economic backwater into a self-styled “socialist market economy.”<sup>7</sup>

Although I also rely on more traditional methods of legal scholarship in this Article, the fact that Chinese real estate and business laws are still in an early stage of development, the speed with which the Chinese legal and economic systems are evolving,

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5. “The emergence of real estate markets in China to their current stage of development has been nothing short of astonishing particularly in the absence of any concept of market structure.” Keith McKinnell & Anthony Walker, *China's Land Reform and the Establishment of a Property Market: Problems and Prospects*, in *THE IMPACT OF CHINA'S ECONOMIC REFORMS UPON LAND, PROPERTY AND CONSTRUCTION* 46 (Jean Jinghan Chen & David Wills eds., 1999) [hereinafter *LAND, PROPERTY AND CONSTRUCTION*]. The changes in China since the late 1980s are similarly remarkable. See Li Ling Hin, *Pricing of Land in China's Reforms*, in *LAND, PROPERTY AND CONSTRUCTION*, *supra*, at 55 (noting that “[b]efore 1987 the portion of the real estate industry in the GNP of the PRC was only around 3–4%, which was substantially lower than most of the East European socialist countries.”).

6. See *infra* notes 84, 102 (discussing statistics reflecting growth in China's real estate sector).

7. The 1982 Chinese Constitution states that the “basic task of the nation . . . is to concentrate its efforts on socialist modernisation.” XIAN FA [Constitution] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 4, 1982, revised Apr. 12, 1988, Mar. 29, 1993, Mar. 19, 1999 & Mar. 14, 2004, effective Mar. 14, 2004), preamble (2004) (P.R.C.) [hereinafter PRC Constitution]. The 1993 revisions added that this task must be accomplished “in accordance with the theory of building socialism with Chinese characteristics.” *Id.* (1993). This last phrase was dropped in 2004, in favor of the term “Chinese-style socialism.” *Id.* (2004). The clause “socialist market economy” first appeared in this paragraph in 1999. *Id.* (2004). Phrasing of this type is not limited to legal documents emanating from Beijing. For example, PUDONG YEARBOOK 2004, the most current edition of an annual publication touting recent accomplishments in the development of the Pudong New Area in Shanghai, states that “Pudong will take [the] lead in basic socialist modernization.” PUDONG NIAN JIAN 2004 [PUDONG YEARBOOK 2004] 18 (2004) [hereinafter PUDONG YEARBOOK 2004].

and the intensely strong cultural tradition of reliance on personal relationships rather than rule-of-law principles all demonstrate why a straightforward doctrinal approach would be incomplete and misleading. My goal here is to establish how this particular aspect of Chinese real estate practice is maturing with what appears to be tremendous success against the backdrop of a young legal system.<sup>8</sup> In future work, I plan to examine other features of current Chinese real estate practice—particularly the mortgage loan market—in the same manner.

Part II of this Article provides an overview and discussion of my research methodology, presents several preliminary observations, and briefly offers some relevant history. Part III describes the typical ownership entity in a Chinese commercial real estate transaction. Part IV discusses site selection. The focus of Part V is on the clearing of the land, with emphasis on the processes commonly employed to remove both existing structures and their current occupants. Part VI defines and describes the Chinese land use right itself, and Part VII presents my conclusions and raises several important and related real estate issues that I will address in later articles.

## II. OVERVIEW AND METHODOLOGY, PRELIMINARY OBSERVATIONS, AND BACKGROUND HISTORY

### A. OVERVIEW AND METHODOLOGY

I first had the opportunity to visit China during the spring of 2003, when I served as a Fulbright Scholar at Shanghai Jiaotong University Law School. I had never before seen real estate development on the scale I observed during this initial stay and knew immediately that I wanted to understand how this nation—with a legal system, history, and cultural background so dramatically different from those of the United States—was managing to accomplish a complete rebuilding of its structures and infrastructure so rapidly.

Although I have been teaching and engaging in scholarship in the areas of real estate finance and land use since 1990, all of my experience prior to my arrival in China was within the context of the American system. So, I initially believed that my very limited Chinese-language communication skills would hinder my ability to undertake this research. I quickly learned that this belief was incorrect. China does not yet have a comprehensive

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8. "The economic bird has already escaped from its cage, the economic plan, but the legal bird remains in its own cage, although it is stirring and the dimensions of the cage may be changing." STANLEY B. LUBMAN, *BIRD IN A CAGE: LEGAL REFORM IN CHINA AFTER MAO 2* (1999) [hereinafter LUBMAN, *BIRD IN A CAGE*].

property law on the books.<sup>9</sup> Furthermore, China's legal system is developing so rapidly that the few property law sources that exist are almost immediately obsolete.<sup>10</sup> Thus even an experienced reader of Chinese would be hampered by a lack of traditional legal materials.

In addition, the legal academy in China still is recovering from the excesses of the Cultural Revolution. This means that there is a shortage of experts in property law and real estate finance just as the nation begins to grapple with the question of how to harmonize private ownership with Communist principles. Those Chinese citizens who have developed expertise in the emerging legal and business systems of China are more likely to be profiting from it than writing treatises about it. In fact, when I returned to China and began meeting with real estate experts, more than one of my counterparts expressed gratitude that I had undertaken this project and indicated how great a need there is for more written material in this field. Many were extremely curious to hear what I had learned from others with whom I had already spoken and insistent that I send them copies of my finished work.<sup>11</sup>

This scarcity of written information led me to conclude that the best way to comprehend the current real estate climate in China and the massive changes of the last decade is to speak to the professionals who are operating within the country. These are the only people who have the expertise and insight that might be found in the United States in the accumulated knowledge of an established law school faculty or in the treatises and primary sources acquired over the decades by a bar association library. So I returned to Shanghai during the summer of 2005 with the goal of interviewing as many people as I could who were knowledgeable about Chinese real estate law and business as actually practiced.

Between May and July of 2005, I interviewed more than fifty experts in the real estate field. Legal experts included practicing lawyers, law professors, judges, government officials with legal training, and law students. Non-lawyer business experts included

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9. See *infra* note 17 & accompanying text, note 96 & accompanying text.

10. Interestingly, the most thorough and complete resource I have found is written in English and published for a Western audience. PATRICK A. RANDOLPH JR. & LOU JIANBO, CHINESE REAL ESTATE LAW (2000) [hereinafter RANDOLPH & LOU, CREL].

11. One real estate developer expressed his frustration that not only are there no sources in this field, there also is no one else conducting research with a goal toward creating any such sources. Our translator, who was reasonably knowledgeable about this area of law, then editorialized that government policies have been changing so fast that anything that could have been published would already be outdated anyway.

real estate developers, bankers, consultants focusing on the real estate sector, economists, business professors, real estate agents, and non-lawyer government officials. Most of these experts are Chinese—some of whom have studied or lived in the West—with the rest being Westerners currently residing in China. Most of the specialists I met were able to converse in English, but in several cases I made use of a translator, including some meetings with persons who speak reasonably good English but felt more comfortable with a translator present. Many of the people with whom I spoke are recent homebuyers themselves.

To the greatest extent possible, I sought out a wide range of viewpoints.<sup>12</sup> At the same time, my selection was not random: I intentionally attempted to reach experts in various different sub-fields, I sought out the most knowledgeable experts I could identify in each of these sub-fields, and some of my interview requests were turned down. Furthermore, my sample was skewed by the obvious reality that all of my interview subjects were people comfortable meeting with an interested foreigner. Thus, “co-operative people were undoubtedly somewhat overrepresented in the sample.”<sup>13</sup> I generally asked questions from a long list I had prepared before my first interview, but this list evolved throughout the weeks of my field research. In addition, I tai-

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12. As Robert Ellickson, author of one of the classic legal field studies, states, “Instead of interviewing many persons who saw the problem from the same perspective, I sought out lesser numbers representing many different perspectives.” Robert C. Ellickson, *Of Coase and Cattle: Dispute Resolution Among Neighbors in Shasta County*, 38 STAN. L. REV. 623, 655 (1986) [hereinafter Ellickson, *Coase and Cattle*]. See also ROBERT C. ELICKSON, *ORDER WITHOUT LAW* (1991) (presenting expanded treatment of his research into informal norms observed by California cattle ranchers).

The problem of finding reliable sources is particularly acute in China. As Professor Donald Clarke notes:

By piecing together information from [a variety of] sources, Chinese and foreign scholars have been able to assemble a picture of certain aspects of the Chinese legal system. That picture is by no means complete. But fleshing it out requires a great deal of thought about what information needs to be gathered and how it can be gathered effectively.

Donald C. Clarke, *Empirical Research into the Chinese Judicial System*, in BEYOND COMMON KNOWLEDGE: EMPIRICAL APPROACHES TO THE RULE OF LAW 164, 167 (Erik G. Jensen & Thomas C. Heller eds., 2003). See also *id.* at 180 (internal citations omitted) (noting that “[f]ieldwork can yield interesting and original results, but unfortunately it typically does not yield representative statistics unless great care is taken in selecting the objects of study”).

13. Ellickson, *Coase and Cattle*, *supra* note 12, at 655. For an extremely thorough discussion of the biases inherent in this type of information-gathering about the Chinese legal system, see Benjamin L. Liebman, *Watchdog or Demagogue? The Media in the Chinese Legal System*, 105 COLUM. L. REV. 1, 11–14 (2005). Professor Liebman emphasizes, for example, how important personal introductions are when conducting field research in China and notes the ways in which this unavoidable bias can affect research results. *Id.* at 13.

lored the questions to the expertise of the particular interviewee, both in my pre-interview preparation and “on the fly,” as each interview progressed. All interviews were face-to-face, with pre-interview logistics and follow-up discussions typically conducted by telephone, e-mail, or text message. I opted not to record my interviews, in part out of a belief that this approach might encourage more frankness from my counterparts.

While I do not rely on doctrinal legal sources to the degree that is typical in law review articles, this Article is also not a journalistic or anthropological account. To the extent I have been able to identify more traditional doctrinal works, I have consulted them and have used these sources as a method of corroborating or challenging the information I gleaned from my interviewees. I cite these works throughout this Article. Where I have unearthed discrepancies between interviews and published sources, I have so noted. These discrepancies might indicate faulty memories, intentional misinformation, or inaccuracies on the part of either the speaker or the published source (or me). They also could reflect the reality that the actual application of published laws in China, as described to me by my counterparts, can vary significantly from the text of those laws.

The Article that follows therefore differs from many of the more traditional works that appear in American law journals. It is not intended to be an authoritative doctrinal treatise on its subject; by necessity, it is impressionistic. It focuses on Shanghai, with secondary emphasis on Beijing, and thus primarily reflects the current state of real estate law and business in those two major cities. A small percentage of the people I met with were not particularly forthcoming, although I nearly always was surprised at how willing these experts were both to meet with a total (and foreign) stranger and to discuss often proprietary aspects of their work. Their forthrightness frequently included direct criticism of government policies, a brave act in a nation where such conduct can subject the speaker to government harassment or worse.

My occasional need to use a translator when interviewing my counterparts<sup>14</sup> introduced barriers, though not always the

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14. The number of Chinese professionals who speak some level of English is growing. Several people suggested to me that China soon will have more English speakers than the United States, although the average level of fluency for these speakers is much lower. However, because the real estate markets are inherently so domestic, real estate lawyers have fewer occasions to cross paths with foreign business people and lawyers and thus less need for English-language fluency. My experience suggests that Chinese real estate lawyers and professionals had lower levels of English proficiency than many other Chinese lawyers and professionals. Conversely, many educated Chinese who are fluent in English have little familiarity with Western real estate concepts and terminology. This occasionally led to translation barriers of a different sort. See *infra* note 15.

precise ones I had anticipated.<sup>15</sup> Several of the people with whom I spoke requested that I not attribute their comments to them, and one even asked me not to take notes during our conversation. Out of respect for the generosity of my conversation partners, and in recognition of the fact that some of them have strong reasons for not wanting attribution, I have decided to refer to all of my contacts anonymously.<sup>16</sup>

My goal here is to convey an up-to-date description of how the players in the world's most explosive real estate market function. They are operating in a wide-open legal environment, with the National People's Congress still debating the nation's first comprehensive property code.<sup>17</sup> They cannot fall back on conventional wisdom in a field in which no one has more than a few years of experience and there are few who can serve as mentors. They also must conduct business under an authoritarian one-party government that severely limits freedom of expression while attempting to merge free markets and strict government control into a system of "socialism with Chinese characteristics."<sup>18</sup> The legal structure is far from transparent, enforcement

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15. Originally, I assumed that speaking through a translator would lead to two primary barriers. First, it would create a "leak" of information that is transmitted twice, as any childhood player of "Telephone" would expect. Second, there would be accompanying delays that tend to stilt conversation. In fact, the main barrier was that my translators were less familiar with real estate finance concepts than either of the two people for whom they were translating. My real estate counterpart and I frequently had to have side discussions with our common translator to ensure that they were properly comprehending and translating the real estate concepts and terms that the two of us were more familiar with using, albeit in different languages.

16. I have opted not to refer to any of my interview subjects by name, and I have occasionally and intentionally been opaque in describing their affiliation or specialty. Although most people I met with expressed no reservations about my identifying them, I do not wish to expose any individual who was kind enough to spend time meeting with me and sharing their expertise to any sort of negative repercussions.

17. It is widely expected that the National People's Congress will adopt this code in March 2007. Recent National People's Congress debates over the proposed in rem property law have exposed serious ideological splits within the Chinese Communist Party, with some arguing for continued rapid development and others responding that this trend is contrary to socialist principles. See Joseph Kahn, *A Sharp Debate Erupts in China over Ideologies*, N.Y. TIMES, Mar. 12, 2006, at A1 (noting "calls to make 'social equity' the focus of economic policy, replacing the earlier leadership's emphasis on rapid growth and wealth creation"). See also LUBMAN, BIRD IN A CAGE, *supra* note 8, at 2 ("[G]iven the novelty of the legal institutions created or revived since the late 1970s, it is no wonder that their development has been limited, hesitant, and uncertain."); *infra* note 96 & accompanying text (discussing the fact that treatment of relocatees is holding up reforms of property law).

18. See, e.g., Keith McKinnell & Anthony Walker, *China's Land Reform and the Establishment of a Property Market: Problems and Prospects*, in LAND, PROPERTY AND CONSTRUCTION, *supra* note 5, at 46-47 (comparing recent changes in behavior with stasis in institutional structure, and quoting Deng Xiaoping's comment, "'The existing political system has now proved to be a formidable constraint to furthering

of the laws that are on the books is inconsistent and commonly graft-ridden, and the rule of law is viewed as a Western concept that does not interlock well with Chinese traditions.<sup>19</sup>

In short, this is a field survey of how the participants in a major and booming industry operate against a background of legal and policy uncertainty. I believe my description to be accurate, I expect it is incomplete, I assume it soon will become obsolete, and I remind the reader that I am attempting to depict Chinese real estate law and business as actually practiced, not as officially written.

## B. PRELIMINARY OBSERVATIONS

Before plunging into my discussion, I set forth here several preliminary observations about China's real estate markets, as a means of highlighting the themes of the discussion that follows. These points merit emphasis at the outset, because they differ significantly from what an American lawyer or business person might predict based on their domestic experience. Thus, these observations serve to remind the reader that the assumptions an American expert brings to the more detailed discussion that follows will not necessarily apply in China.

First, it is important to remember that all legal structures and institutions in this area of Chinese law are new and still evolving. Thus, nothing is time-tested.<sup>20</sup> As a result, lawyers and

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the course of economic reform.”); *supra* note 7 (discussing evolving language of Chinese Constitution regarding the role of socialism).

19. See, e.g., LUBMAN, *BIRD IN A CAGE*, *supra* note 8, at 11 (“The rule of law was alien and unknown [in China] throughout thousands of years of authoritarian rule.”). Western observers today generally seem to believe that China is well on the road to accepting at least a thin core of rule-of-law principles. See, e.g., PEERENBOOM, *LONG MARCH*, *supra* note 2, at 20 (“the notion that the PRC economy will be able to sustain economic growth without further legal reforms that bring the system into greater compliance with the basic requirements of a thin conception of rule of law is doubtful”). Professor Peerenboom also notes, however, that some scholars, particularly those in the Critical Legal Studies school, believe that Western imposition of rule-of-law concepts on China is a thinly veiled attempt to oppress and inflict injustice. *Id.* at 164.

20. “Legal reform has been driven by economic reform, and virtually every element of Chinese law today was either revived or newly created in the course of two decades of extraordinary economic and social change that have begun to transform Chinese society.” LUBMAN, *BIRD IN A CAGE*, *supra* note 8, at 102. See also PEERENBOOM, *LONG MARCH*, *supra* note 2, at 268 (“Inevitably, rules change more often during periods of transition, leading to instability and inconsistency”). One pair of commentators described the Chinese market as of 1999 as an “embryo.” Keith McKinnell & Anthony Walker, *China's Land Reform and the Establishment of a Property Market: Problems and Prospects*, in LAND, PROPERTY AND CONSTRUCTION, *supra* note 5, at 48.

real estate developers frequently operate by trial and error.<sup>21</sup> Second, and following from the first point, there are no seasoned experts in the field. The most senior real estate professionals in China have plied their trade for little more than a decade and have experienced only boom times. This Gold Rush mentality and lack of experience is visible throughout the real estate market.<sup>22</sup> Third, there is a much greater reliance on personal relationships (*guanxi*) than in Western nations.<sup>23</sup> International demands that China adhere to rule-of-law principles garner much attention in China but often are given little more than lip service.<sup>24</sup> “[T]here is a significant gap between the law-in-the-books and the law-in-action, between enacted rules and actual practice, and between the officially professed ideals and objectives of the legal system on the one hand, and on the other hand its practical management, operation and impact on those who come into contact with it.”<sup>25</sup>

Fourth, the Chinese legal system is surprisingly undeveloped given how advanced the Chinese property markets have become.<sup>26</sup> A casual observer viewing Shanghai’s skyline for the

21. “In China today . . . rules are being adopted even while new transactions are themselves emerging and before much experience has been accumulated about them.” LUBMAN, *BIRD IN A CAGE*, *supra* note 8, at 175.

22. This same comment could be made about various other areas of Chinese life. For example, most automobile drivers have been operating a motor vehicle for no more than a few years, and the staid looking forty-five year old driver of that Shanghai GM sedan that is bearing down on you probably has no more experience or good judgment behind the wheel than the typical American teenager.

23. “[T]he Chinese emphasis on relationships (*guanxi*) seems to have had a strength and durability for thousands of years that make it more powerful and pervasive than comparable Western emphases.” LUBMAN, *BIRD IN A CAGE*, *supra* note 8, at 304. Professor Lubman also notes, “In China, rights and duties are contextual, depending on the relationship of individuals to each other, and each conflict must be addressed in terms of the alternative consequences with a view to finding a basis for cooperation and harmony.” *Id.* at 19 (internal citations omitted).

24. In a foreword to an earlier edition of Professor Albert H.Y. Chen’s extremely useful treatise on Chinese law, Professor Jerome Cohen writes, “Mr. Chen keeps a sharp eye on the gap between law and life, between theory and practice. This is an indispensable element in accurately portraying any system, but particularly one where the gap is often very great and so too is the government’s effort to conceal it.” ALBERT H.Y. CHEN, *AN INTRODUCTION TO THE LEGAL SYSTEM OF THE PEOPLE’S REPUBLIC OF CHINA* x (3d ed. 2004) [hereinafter CHEN, *INTRODUCTION*] (quoting from Foreword to the First Edition, published in 1992, by Jerome Alan Cohen).

25. *Id.* at 202. Professor Chen continues by noting that closing this gap constitutes an important part “of the ongoing project of building a sound legal system for China.” *Id.*

26. “Chinese economic success defies conventional theory, which requires, as one economist has observed, that ‘To function anywhere near its potential, any economic system must have property rights that are much better defined and enforced than is true of China’s mixed economic system today.’” LUBMAN, *BIRD IN A CAGE*, *supra* note 8, at 117 (internal citations omitted). “Neither the game nor its rules . . .

first time would assume that Chinese property law has matured significantly since Mao's death, but this assumption is only partly accurate.<sup>27</sup> Those who work within China's real estate market often can only guess how problems that might arise in the future will be resolved.<sup>28</sup> And legal changes, though rapid, often have been incremental, responding to only the most immediate needs.<sup>29</sup> Fifth, in spite of some movement by China toward a freer and less regulated market, those who operate within the Chinese legal and economic system still must endure a far greater level of government involvement, intrusion, and interference than American real estate professionals typically experience. More generally, there is a lack of transparency within the legal system, and citizens simply take it as a given that the results of an individual's actions may be difficult to predict. Finally, things continue to change dramatically and rapidly, as Chinese citizens develop more expertise, as the government reverses course and then doubles back again, and as foreigners continue to exert increasing influence, both through their personal business activities and their institutional law reform efforts.

### C. BACKGROUND HISTORY

Show me a Chinese centenarian and I will show you a person who has lived through unbelievable change in her lifetime. She will have been born in the waning days of the Qing Dynasty, with the Last Emperor soon to succumb to the republican revolu-

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seem to be free from ambiguity." *Id.* at 174. More generally, "because of the absence of a unifying concept of law and a considerable fragmentation of authority, China does not have a legal system." *Id.* at 317 (emphasis in original). *But see* PEERENBOOM, LONG MARCH, *supra* note 2, at 565–68 (strongly contesting this last argument).

27. "[T]he fact that the law sometimes lags behind the rapidly changing circumstances of economic reform . . . has a negative effect on legal efficacy." CHEN, INTRODUCTION, *supra* note 24, at 116.

28. "[F]ormal legal institutions . . . have to struggle against the cultural and social forces in Chinese society that tend to weaken and undermine property rights." LUBMAN, BIRD IN A CAGE, *supra* note 8, at 118.

29. *See, e.g.*, PEERENBOOM, LONG MARCH, *supra* note 2, at 558–59 (noting the parallels between incremental economic reforms during the 1990s and incremental legal reforms more recently); XIN CHUNYING, CHINESE LEGAL SYSTEM & CURRENT LEGAL REFORM 343 (1999) [hereinafter XIN, CHINESE LEGAL SYSTEM] (noting that Chinese legal reform has been "carried out step by step and in an orderly way"). In a phrase often attributed to Deng Xiaoping, the process of reform is comparable to "crossing the river by feeling the stones." *See, e.g.*, *Caution against loopholes in reform*, CHINA VIEW, Mar. 24, 2006, available at [http://news.xinhuanet.com/english/2006-03/24/content\\_4339286.htm](http://news.xinhuanet.com/english/2006-03/24/content_4339286.htm) (last visited Mar. 7, 2007) (contrasting a more modern reform plan proposed in Shenzhen with an incremental approach and attributing this phrase to Deng).

tion of 1911.<sup>30</sup> A quarter-century of upheaval followed, marked by four years of a shaky republic, twelve years of regional control by warlords, and the establishment of the Nationalist government in 1928, alongside the growth of the Communist Party.<sup>31</sup> Nationalist control of much of China gradually gave way to invading forces from Japan. The Japanese ruled the northern and eastern portions of China—including Shanghai and, most brutally, nearby Nanjing—for nearly a decade.<sup>32</sup> Four years of uncertainty and civil war followed the departure of the Japanese.<sup>33</sup> Then came the quarter-century of Mao Zedong's rule, difficult and often brutal years marked ultimately by the nationalization of all land in China.<sup>34</sup>

This process of land nationalization started to reverse itself with the death of Mao and the subsequent ascension to power of Deng Xiaoping. A market-based economy began reappearing during this time. The Chinese Constitution of 1982 was amended in 1988 to allow for the creation of transferable land use rights, and the Land Administration Law was adopted in 1986 and revised in 1998 and 2004.<sup>35</sup> In his final years at China's helm, Deng sparked the re-ignition of China's economy with his "reform and

30. The revolution "was triggered by an accidental bomb explosion" on October 9, 1911. JONATHAN D. SPENCE, *THE SEARCH FOR MODERN CHINA* 262 (1990) [hereinafter SPENCE, *MODERN CHINA*]. Puyi, the last emperor of the Qing Dynasty, abdicated on February 12, 1912. *Id.* at 267; PATRICIA BUCKLEY EBREY, *THE CAMBRIDGE ILLUSTRATED HISTORY OF CHINA* 266 (1996) [hereinafter EBREY, *CAMBRIDGE HISTORY*].

31. EBREY, *CAMBRIDGE HISTORY*, *supra* note 30, at 266–67, 273–78. For a discussion of the early days of the Chinese Communist Party, see JOHN KING FAIRBANK & MERLE GOLDMAN, *CHINA: A NEW HISTORY* 275–78 (enlarged ed. 1998) [hereinafter FAIRBANK & GOLDMAN, *CHINA HISTORY*]. For a discussion of Mao Zedong's rise, see *id.* at 301–05.

32. SPENCE, *MODERN CHINA*, *supra* note 30, at 443–83; EBREY, *CAMBRIDGE HISTORY*, *supra* note 30, at 282, 284–86. A majority of China's population lived in land controlled by Japan. FAIRBANK & GOLDMAN, *CHINA HISTORY*, *supra* note 31, at 312.

33. SPENCE, *MODERN CHINA*, *supra* note 30, at 484–513; EBREY, *CAMBRIDGE HISTORY*, *supra* note 30, at 286–90.

34. Although some Chinese land was nationalized immediately after the establishment of the People's Republic in 1949, much of it was not, especially in urban areas. As late as 1955, two-thirds of the housing stock in Shanghai still was provided by the private sector. Yan Song, Gerrit Knaap & Chengri Ding, *Housing Policy in the People's Republic of China: An Historical Review*, in *EMERGING LAND AND HOUSING MARKETS IN CHINA* 164 (Chengri Ding & Yan Song eds., 2005) [hereinafter *LAND & HOUSING*]. The final stages in the land nationalization process arguably did not occur until six years after the death of Mao Zedong. RANDOLPH & LOU, *CREL*, *supra* note 10, at 11 (observing that some Chinese scholars contend that the nationalization of all land in China was not complete until 1982).

35. See *infra* notes 104–09 & accompanying text. See also Dale A. Whitman, *Chinese Mortgage Law: An American Perspective*, 15 *COLUM. J. ASIAN L.* 35, 37–40 (2001) (offering a thorough and succinct summary of relevant Chinese real estate law principles).

opening” policy, and the Chinese economy has grown at breakneck speed since the early 1990s. Having previously completed its nationalization of the ownership of all real property in China, the government now took steps to allow private citizens to control the use of land, by granting long-term land use rights to those who wished to develop the real estate.

Shanghai, a major international city that had been stuck in neutral for decades, began to re-emerge during the 1990s. In the years since Deng catalyzed the reopening of China’s economic system, Shanghai has seen the construction of twelve buildings that are more than 225 meters in height, including Jin Mao Tower, the tallest building in mainland China and the fifth tallest in the world (at least for a short while longer).<sup>36</sup> The government initiated the development of the Pudong New Area, just across the Huangpu River from downtown Shanghai, in effect building a city about the size of Chicago in less than fifteen years right next to the previously existing city of Shanghai.<sup>37</sup> Shanghai is stunning not just for its new steel-and-glass structures or its handful of signature skyscrapers, but for its unbelievable number of ordinary thirty- and forty-story buildings packed together. It is a city both vertical and horizontal, expanding relentlessly upward and outward at the same time and at an ever-accelerating pace.<sup>38</sup>

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36. Emporis Buildings, Buildings – Official World’s 200 Tallest High-rise Buildings, <http://www.emporis.com/en/bu/sk/st/tp/wo/> (last visited Mar. 7, 2007). The five tallest buildings in the world currently are Taipei 101 (Taipei, Taiwan); Petronas Towers 1 and 2 (Kuala Lumpur, Malaysia); the Sears Tower (Chicago, Illinois); and Shanghai’s Jin Mao Tower, which tops out at 421 meters. *Id.* Of the world’s 200 tallest buildings, 22 are in New York, 17 are in Hong Kong, and 12 each are in Shanghai and Chicago. *Id.* Emporis ranks Shanghai’s skyline as the world’s sixth most impressive, behind those of Hong Kong, New York, Seoul, Chicago, and Singapore, using a somewhat arbitrary formula that assigns progressively larger numbers of points for taller and taller buildings. Emporis Buildings, Buildings – Emporis Skyline Ranking, <http://www.emporis.com/en/bu/sk/st/st/> (last visited Mar. 7, 2007).

37. In the late 1980s, Pudong was a relatively inaccessible area east of Shanghai’s Huangpu River, occupied mainly by farms, warehouses, and scattered residences. See TIM CLISSOLD, MR. CHINA: A MEMOIR 243 (2004) (recalling seeing water buffalo in Pudong in the early 1990s). On April 18, 1990, the National People’s Congress announced that the Pudong area would be developed at a rapid pace, “to make Pudong one of the international centers for economy, finance and trade, to open up further the cities along the Yangtze River . . . so as to accelerate to a new stage the development of the Yangtze River Delta and the regions along the river.” PUDONG YEARBOOK 2004, *supra* note 7, at 8. By 2003, Pudong had been redeveloped into a modern and largely urbanized area with 2.7 million permanent residents.

38. “[T]otal housing investment in Shanghai in 1997 was more than 190 times that in 1978.” Xing Quan Zhang, *Development of the Chinese Housing Market*, in LAND & HOUSING, *supra* note 34, at 183.

### III. THE OWNERSHIP ENTITY

#### A. THE STRUCTURE OF THE OWNERSHIP ENTITY

Most real estate projects in Shanghai are domestically owned, primarily in the form of limited liability companies.<sup>39</sup> The first task of a newly formed limited liability company is to acquire land use rights, which are devices by which a unit of government permits private control and development of land without technically conveying ownership.<sup>40</sup> In many cases, the entity that obtains the land use right is itself partly owned by a private developer-manager and partly owned by a government entity.<sup>41</sup> This structure often results from the fact that a local government entity<sup>42</sup> controls the use of the land that the developer needs and provides the land use right to the ownership entity as its contribution to that entity.<sup>43</sup> In other words, the local government controls an essential ingredient—the land use right—and uses its control of that asset as a means of gaining an ownership interest in the entity that will develop the land.

By making an in-kind contribution to the ownership entity, the government retains partial ownership in the project, a fact

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39. Limited liability companies are formed in accordance with the Company Law, which was adopted in 1993 and modified in 1999 and 2005. Gongsì fa [Company Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1993, revised Dec. 25, 1999 and Oct. 27, 2005, effective Jan. 1, 2006), arts. 23–76 (2006) (P.R.C.) [hereinafter Company Law]. See generally CHEN, INTRODUCTION, *supra* note 24, at 245 (discussing earlier version of law). In addition to allowing for the creation of limited liability companies, the Company Law also provides for the establishment of joint stock limited companies. Company Law, arts. 77–146 (2006). See generally JAMES M. ZIMMERMAN, CHINA LAW DESKBOOK 128–31 (2d ed. 2005) [hereinafter ZIMMERMAN, DESKBOOK] (translating the name of the latter entity as “company limited by shares”; discussing earlier version of law). The minimum registered capital requirements for joint stock limited companies are much higher than the parallel requirements for limited liability companies, which probably helps to explain why real estate entities generally are formed as limited liability companies. Compare Company Law, art. 26 (2006), with *id.*, art. 81 (2006).

40. See *infra* Part VI for a detailed discussion of the land use right and its legal basis.

41. Article 27 of the Law on the Administration of Urban Real Estate seems to permit such a structure. Chengshi fangdìchān guānlǐ fǎ [Law on the Administration of Urban Real Estate] (promulgated by the Standing Comm. Nat'l People's Cong., July 5, 1994, effective Jan. 1, 1995), art. 27 (1995) (P.R.C.) [hereinafter Law on Admin. of Urban Real Estate].

42. In many cases, there are significant differences in authority and policy among local governments at the city and county level, provincial and municipal governments, and the central government. In cases where this difference is significant, such as in the text reference here, I am careful to refer to a specific level of government. When I use the more generic term “government,” I am intentionally using it more inclusively to refer to government at any level.

43. See Company Law, art. 27 (2006) (stating that a shareholder of a limited liability company may make its capital contribution by “contributing such non-currency property as . . . land-use rights” and requiring that these rights be appraised).

that allows the local government both to retain control over the development and to profit from it.<sup>44</sup> The other partner provides the professional know-how and much of the cash. It appears that the size of the fractional interest in the ownership entity that local governments demand has been dropping over time—one expert suggested that the percentage of a typical project owned by the government partner has dropped from 60% to 40%—and that many of these joint ventures are now controlled by the private party. Similarly, state-owned enterprises (SOEs) sometimes receive land use rights from local governments at little or no cost, or already own them, and then contribute these rights to a development entity that they jointly own with a local developer or, occasionally, a foreign partner.

This government participation<sup>45</sup> in real estate ventures is not surprising, for several reasons. In the earliest days of the modern Chinese real estate market, SOEs or the government itself had to jump-start the development industry, as there simply was no one else with any expertise.<sup>46</sup> Even as China's real estate industry has matured and private entities have acquired the experience and confidence necessary to take more prominent roles in the development process, there are many reasons for the government to continue to invest. China's real estate market is booming, particularly in the larger cities in the eastern part of the country, and government entities wish to ride the real estate wave to huge profits.<sup>47</sup>

SOEs, which generally are inefficient and lag in their operations as compared to other businesses, have recently been attempting to diversify into this successful industry to improve their overall performance. Since SOEs historically have comprised part of the "iron rice bowl" social service network, often

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44. One pair of commentators indicates that political units have theoretically been prohibited from profiting from real estate development in this manner since 1990. RANDOLPH & LOU, CREL, *supra* note 10, at 132–34. However, several of the experts I interviewed referred rather matter-of-factly to the current existence of these types of public-private real estate joint ventures.

45. Also note that most banks operating in China are government-owned or -controlled. As a result, approval of real estate loans may be motivated as much by the government lender's desire to implement its own national policy as by its desire to be repaid with interest.

46. This pattern differs somewhat from that displayed by manufacturing ventures, in which foreign companies felt more comfortable forming joint ventures with Chinese enterprises and entering the Chinese market earlier. Perhaps foreign companies believed that manufacturing goods in China would be less different from manufacturing goods elsewhere than developing real estate in China would be from developing real estate elsewhere.

47. *But see infra* notes 93–97 & accompanying text (suggesting that some of these profits may be coming at the expense of rural peasants, a fact that has been leading to growing unrest in the countryside).

providing workers with a guaranteed job, housing, schools, and health care, the government wants these entities to survive.<sup>48</sup> If an SOE fails, either the government must step in and provide these benefits or the SOE's former employees will suffer the type of reduction in comfort and security that can lead to more generalized social unrest.<sup>49</sup> Nonetheless, the rapid increase in the number of private businesses and the quick growth in foreign trade has caused some SOEs to fail, which places the government in the position of having to sell off a bankrupt enterprise's assets. To the extent those assets include desirable real estate, the government may wish to profit from this newly available investment opportunity, thereby increasing the SOE's salvage value.<sup>50</sup>

By co-owning the development entity, the government also is able to exert significant control over the construction process and the ultimate product. One speaker suggested to me that most of the residential real estate developers in Shanghai are entirely state-owned: The local government forms entities that it owns or controls and then directs prime land to them. Naturally, all of this government participation in the real estate industry makes it more difficult for private companies to compete.

Much like the SOEs, private companies with a primary emphasis in industries other than real estate are seeking to diversify

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48. "Because the large SOEs are responsible for many aspects of the lives of their workers, reforming them presents social and political as well as economic challenges. Dismantling them would threaten to throw huge numbers of workers into unemployment, and a nationwide safety net does not exist." LUBMAN, *BIRD IN A CAGE*, *supra* note 8, at 107.

The responsibility for housing workers that is borne by the SOEs reflects the belief, now becoming discredited in China, that housing for workers is not a commodity but rather is a necessary cost of manufacturing a product. Jean Jinghan Chen & David Wills, *Pioneer Urban Housing Reform in China*, in *LAND, PROPERTY & CONSTRUCTION*, *supra* note 5, at 123 ("Traditionally, housing in China has been viewed as a non-useful cost of production that must be borne to produce the truly valued output which consists of manufactured goods."). While the government may want SOEs to continue to provide housing and other benefits to their workers, the cost of furnishing these services renders SOEs uncompetitive in global markets. *Id.* at 125 ("The housing burden of the SOEs has been one of the fundamental reasons for their inefficiency and their incurred production losses.").

49. "The one indignity the Chinese people will not tolerate is the destruction of their savings. The population's unspoken truce with the country's autocratic leaders has long been that they must continue to deliver improved living standards in return for maintaining power." JOE STUDWELL, *THE CHINA DREAM: THE ELUSIVE QUEST FOR THE GREATEST UNTAPPED MARKET ON EARTH* 278 (2002) [hereinafter *STUDWELL, CHINA DREAM*].

50. If the government has already established a land use plan covering this land, it now has an incentive and the capability to ignore this plan. One expert suggested to me that a major reason for the failure of land use planning in so many parts of China is the conflicting stimuli affecting government entities in this situation: Faced with the desire to implement a much-needed land use plan and the ability to profit from the real estate boom, Chinese government entities often choose the latter. *See infra* note 129 & accompanying text.

their portfolios, and real estate has proved to be one of the most successful investment sectors during the last several years. The government, reluctant to allow competition from these wealthy private entities, has begun to limit the ability of these companies to operate in the real estate arena. It even has taken steps to encourage these companies to sell their real estate assets to state-owned real estate holding companies, so that the government rather than the private former owner can enjoy the future profits from the real estate.

## B. THE IMPORTANCE OF PERSONAL CONNECTIONS

Local governments sometimes convey a land use right to a public-private joint venture ownership entity for less than the land is worth.<sup>51</sup> The entity then can quickly resell a portion of the land use right at a higher price per square meter and recoup some or all of its total cash investment in the project before it begins construction. The end result of this two-step transaction is that the entity can obtain the right to develop its remaining land for free or at a steep discount. This suggests that the private co-owner of the entity often is someone with close connections to the government, such as a former government official, or that the private partner has otherwise induced the government entity to sell the land initially at a bargain price.

Land has become the hottest of commodities in many parts of China, and government units that wish to profit from developing land may lack the necessary expertise. Those professionals who possess this know-how and are willing to share the spoils with the government—or certain workers within the government—are more likely to obtain the coveted land use rights. Even in cases in which there is no outright corruption, developers and lawyers who master the nuances of an ever-changing legal and administrative system and maintain cordial relations with the bureaucrat whose approval is essential hold a huge advantage over their competitors. Given how rapidly China's business laws are developing and how sporadically and inconsistently they are applied, *guanxi* is likely to remain an important factor in these business dealings for the foreseeable future.

In recent years, however, fair public auctions have become far more common, as various levels of Chinese government en-

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51. Keep in mind that the concept of land's "worth" is a sticky one in a nation in which the real estate market is nascent. Land use rights, which are already time delimited, have been available on the market for only a brief time. Moreover, the land that the government is offering is land that has not been privately held in recent years. This uncertainty about the land's value is compounded by the overall volatility of China's young real estate markets.

deavor to fend off charges of corruption. I was regularly told by different players in the Shanghai real estate market that that city runs one of the cleanest operations in China<sup>52</sup> and that auctions of land use rights have become fairly transparent and open during the past several years.<sup>53</sup>

Even if procedures in parts of China are becoming more fair and transparent, the early developers—the initial beneficiaries of a system that rewarded *guanxi* even more overtly—still have a huge competitive edge. By building their projects at a time when the market was difficult to enter without connections, they became the market leaders. Their connections afforded them the opportunity to obtain the experience and skills that they and others lacked. This newfound expertise complements their personal contacts and allows these industry leaders to maintain their head-start to a degree that later market entrants have had difficulty reducing.

Some of these early developers, having benefited from the Wild West real estate environment of the 1990s, may have encouraged the adoption of legal changes to make the rules more fair: Having established a huge lead, they now wished to lock in their advantage by ensuring that no one else can ever do what they succeeded in doing when the rules were more lax.<sup>54</sup> Many real estate transactions today are limited to those developers with demonstrated success and the proven capacity to finance and construct major projects, a group that largely consists of those who could acquire land use rights under the more opaque procedures prevalent in the initial days of the current boom. And if *guanxi* is not as essential as it once was, it surely does not

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52. See, e.g., Jamie P. Horsley, *Shanghai Advances the Cause of Open Government Information in China*, China Law Center, Yale Law School, available at [http://www.law.yale.edu/documents/pdf/Shanghai\\_Advances.pdf](http://www.law.yale.edu/documents/pdf/Shanghai_Advances.pdf), at 3 (last visited Mar. 7, 2007) (noting ways in which Shanghai has been making urban planning and redevelopment processes more transparent). See also YATSKO, *NEW SHANGHAI*, *supra* note 4, at 216 (“Western investors . . . often comment that Shanghai authorities follow the rules compared with Chinese officials in the provinces, particularly in southern China. . . . They also find Shanghai to be a relatively ethical place to do business, particularly compared with southern China”). But see James T. Areddy, *Corruption Crackdown Targets Shanghai Inc.: Beijing Sends Signal, Stalling Glitzy Projects of City’s Ousted Chief*, WALL ST. J., Feb. 6, 2007, at A1 (discussing firing and detention of Chen Liangyu, Shanghai’s Communist Party Secretary, following allegations of “mismanagement and theft . . . , influence peddling and other misdeeds”).

53. For a discussion of how Shanghai has modified its procedures for transferring land use rights, see *infra* notes 119–22 & accompanying text.

54. Interestingly, one of the Chinese people I interviewed compared the advantage enjoyed by these early entrants with *guanxi* to the one he perceives the United States as enjoying under the World Trade Organization. He suggested that those who are “in the lead” cement their benefits by encouraging the enactment of facially neutral rules that serve to institutionalize their advantage.

hurt even today. These realities also help to explain why most successful real estate developers in China are Chinese.

### C. FOREIGN AND DOMESTIC INVESTORS

To the extent there is foreign investment in real estate ownership entities, it overwhelmingly comes from overseas Chinese in places such as Hong Kong, Taiwan, and the United States.<sup>55</sup> Multinational corporations also have entered the market recently. Morgan Stanley, Merrill Lynch, and Citigroup are among the well-known overseas entities that have made significant investments in Shanghai real estate during the past few years, often in high profile locations such as the Lujiazui Trade and Finance Zone of Shanghai's Pudong New Area. But the government still restricts the ability of foreigners to invest in real estate, especially in commercial and luxury residential projects. The experts I spoke with disagreed about whether the government has permitted any of these top-tier projects to be wholly foreign-owned. One developer told me that these internationally known foreign entities insist on owning their projects, while a real estate agent insisted that the first-class office buildings in Pudong remain state-owned, as the government continues to require public ownership as a means of controlling the development process and making the money that results.

Moreover, in some areas that were less intensively developed before the current real estate boom, such as portions of Pudong, the municipal government established first-level developers and conveyed the empty or nearly empty land to these state-owned entities. These entities installed basic infrastructure, subdivided the land, and conveyed the land use rights in the smaller subdivided parcels to the parties that ultimately developed them or will do so. This process ensured that the government would profit from the increased value brought about both by the installation of the infrastructure and by more general appreciation in land values, while also limiting competition among sellers so as to maintain high prices. It also served to keep the profits from the appreciation of this land within China, as foreign entities would have lacked the ability to obtain land use rights in the first instance. The municipal government played a role similar to that of a subdivider in an American residential development, but with the added advantages of being able to monopolize most or all of the land while also controlling its permissible uses.

General contractors sometimes serve as joint owners of real estate entities as well. This may sound like good investment fore-

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55. This Article employs a definition of "overseas Chinese" that includes Chinese residents of Taiwan, Hong Kong, and Macau.

sight by builders who hope to profit from the ownership of the project and not solely from the construction process, and in some cases it may be precisely that. More often, though, this appears to be a form of developer financing. In the earlier days of the modern Chinese real estate market—which is to say, a few years ago—cash-strapped developers often would pay their contractors very slowly. In effect, they were forcing these contractors to extend interest-free loans, by having them contribute materials and labor for which they would not receive payment for months. And if the project failed, the contractors would become unwilling partners in the risk, as they would be unlikely to receive payment at all.

The government, in one of many efforts to slow what it feared was becoming a real estate bubble, has placed restrictions on the ability of owner entities to pay their contractors slowly. The intent is to ensure that developers have cash on hand before incurring contractual obligations to their contractors. If it works, this policy will mean that developers are more stable financially and that contractors are more likely to be paid for their work. Developers, however, have quickly learned to evade the effect of these restrictions by bringing their contractors in as minority co-owners. The contractor's provision of materials and labor presumably is viewed not as its performance under a contract, for which payment is due, but rather as its contribution to the entity, for which it has already received consideration in the form of its minority interest in the entity.

This discussion of ownership entities cannot be considered complete without a brief discussion of the Wenzhounese. In the early days of China's new real estate market, most citizens gave little thought to investing in land and buildings. The concept was simply an alien one to the hundreds of millions of people emerging from nearly half a century of strict Communist rule and collective ownership of property. Residents of Wenzhou, in Zhejiang Province on the nation's east coast, were ahead of the real estate investment curve and were among the first Chinese citizens to begin investing in the young market.<sup>56</sup> Wenzhounese would collect money via "the tin plate," effectively passing the hat to amass sufficient funds to buy a project together. These rudimentary joint ventures helped to spark the real estate market at a time when most other investors chose to hold back or never dreamed of investing in real estate in the first place. They also established a disproportionate number of Wenzhounese as lead-

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56. See *STUDWELL, CHINA DREAM*, *supra* note 49, at 34–37 (describing Wenzhou's economic rise since the 1980s and attributing it to a combination of individual resourcefulness and geographic isolation).

ers in the real estate industry. When other Chinese saw how well these Wenzhounese investors were faring, the real estate market began to take off more broadly.

#### IV. CHOOSING A SITE: LOCATION, LOCATION, INDUCEMENT, COMPULSION

##### A. PROFIT MOTIVE AND GOVERNMENT CONTROL

In China's socialist market economy, the decision about where to build is resolved, not surprisingly, by a combination of private profit motive and government inducement or compulsion. Developers seek to buy land use rights and then build structures on that land in locations that will be profitable. The government simultaneously uses its power—including both its ownership of the underlying land and its position as an equity holder in many developer entities—as a means of channeling development where it wishes. To the extent that the government hopes to force development of areas that are sparsely populated, it also benefits from the business reality that it is far more advantageous for private developers to build on land from which developers will not have to remove current occupants and structures, a process that can be both controversial and expensive.<sup>57</sup>

The profit motive of real developers requires no explanation and seems to cross international cultural barriers with little need for translation. The developers I interviewed generally wish to make money and seemed a bit surprised that an American would see any need to ask a Chinese developer about this. These professionals also recognize that they are working in an environment that is heavily regulated. Thus, I sought to understand the goals and mechanisms of China's land use controls.

##### B. GOVERNMENT PLANNING AND PUBLIC INPUT

Chinese government entities do engage in land use planning and zoning. While China's methods of regulating land use are not the principal topic of this Article, it is fair to summarize these processes by stating that the government's land use plans are developed in a top-down manner, with little or no citizen input.<sup>58</sup>

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57. See *infra* note 100 & accompanying text.

58. See, e.g., Chengshi guihua fa [City Planning Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 26, 1989, effective Apr. 1, 1990), art. 4 (1990) (P.R.C.) ("The state shall guide itself by the principle of strictly controlling the size of large cities and developing medium-sized and small cities to an appropriate extent in the interest of a rational distribution of productive forces and of the population."); *id.* art. 6 (1990) ("The compilation of the plan for a city shall be based on the plan for national economic and social development"); *id.* art. 11 (1990) (describing "the compilation of hierarchical urban plan[s] for the whole nation").

In nearly every conversation I had, I asked my Chinese counterparts if they could provide me with an example of citizen input into any aspect of land use planning. In three months of interviews, they provided me with only one concrete illustration: The dramatic 360° circular exit ramp on the Puxi side of Shanghai's new Nanpu Bridge was suggested to planners by a twelve-year-old girl. As one Western lawyer succinctly explained to me, the Chinese government has much more power to force things than in the United States.<sup>59</sup>

One expert advised me that some government entities do invite public comment, but that citizens' suggestions are followed only rarely. Rejecting or discouraging input from the very people who will be most affected by land use regulations surely must hamper government planning efforts. Nonetheless, the government has become more keenly attuned to the need for better land use planning and environmental control in recent years. Even a government-mandated plan may be preferable to haphazard and aimless construction; even a government that is indisposed to follow citizen input will get it right sometimes. A Chinese lawyer also told me that citizen input may have more impact regarding changes to existing land use plans than initial plans. This implies that the government will not listen to its citizens until after it has mis-stepped once on its own and needs advice on how to correct course.

Recently, the land use planning process has become more transparent, though hardly more citizen-based. Shanghai, for instance, engages in multiple levels of planning. The first step is "Open Planning," in which Shanghai's municipal government makes a proposal that must be approved by both the Shanghai Municipal People's Congress and the State Council. Following

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The City Planning Law does not appear to require public input at any point during the planning process.

59. One Chinese real estate consultant told me that "people in China don't like to give suggestions. They think the government will do everything. So the people don't have the motivation." Another possible explanation is that because citizen input has been devalued for so many years, China's citizens are simply unfamiliar with the concept. Numerous conversations with my own students—who seemed baffled by the idea of citizen input into government decisions of any type—have persuaded me that this may be an important factor in the lack of citizen involvement in the land use planning process. Shanghai's residents still may be gun-shy, as well. In the past, those who offered suggestions that contradicted the plans of government officials often came to regret it, so local residents may have decided that the best course is to remain unobtrusive.

Cf. Jamie P. Horsley, *Village Elections: Training Ground for Democratization*, CHINA BUS. REV., Mar.-Apr. 2001, at 44, 51 (tracing increases in citizen participation since the early 1980s and describing process as "the world's largest grassroots democratic education process," but also noting continuing need for "nurturing a society that understands the rights and responsibilities of citizens in a modern state").

successful completion of this step, the Shanghai Municipal People's Government (or, for less significant projects, the Shanghai Urban Planning Administration, an administrative arm of the municipal government) specifies requirements for individual blocks of land. Subsequent rezonings, while occasionally available, are difficult to obtain. Then, in the third step, technical specifications are proposed for individual buildings. Steps four and five consist of bidding on the transfer of specific land use rights and the execution of a contract with the successful bidder.<sup>60</sup> These steps appear to mirror to some degree the land use process in the United States, although the Chinese process provides virtually no opportunity for input from outside the government, even by those considering bidding.

In the first days of Shanghai's real estate boom, potential real estate developers could become involved in the planning process even earlier. Back in the 1990s, the government would ask developers to find a block and propose a real estate development for that block. Developers then could locate land they wished to develop and pitch their proposals to the government. This method is rarely used today. Rather, the government either makes its planning decisions in the manner described above and invites proposals from developers who must comply with these detailed specifications, or it invites proposals for specific blocks that it has designated but not yet planned in great detail so that the developer can participate in the later stages of the planning process. By relying on these latter methods today, the government maintains additional control over land use policy and also retains a greater ability to slow down an already overheated real estate market.

### C. POPULATION DISPERSAL

Shanghai also has sought recently to reduce population density in its urban core and promote new development in outlying areas of the vast municipality.<sup>61</sup> The Shanghai government previously had set up satellite communities as commuter towns in re-

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60. See *infra* notes 119–22 & accompanying text (discussing Shanghai's process for transferring land use rights).

61. Shanghai Municipality covers 6,340.5 square kilometers, but only about one-third of this area is urbanized. The remainder of the municipality's area is used in a variety of ways, including as agricultural land and forests. Population density in Shanghai ranges from 50,939 persons per square kilometer in the downtown Huangpu district to only 615 persons per square kilometer in outlying Chongming County. Basic Facts – Changes In The City's Population, <http://www.shanghai.gov.cn/shanghai/node8059/BasicFacts/PopulationandEmployment/userobject22ai8465.html> (last visited Mar. 7, 2007). I occasionally observed small farms tucked in between heavily developed urban areas along the road connecting downtown Shanghai and the outlying Minhang District.

mote and more thinly populated portions of Shanghai. As the populations of these outlying townships has swelled and automobile traffic downtown has become a huge problem, the government has accelerated the dispersal process still further by trying to relocate selected industries to these satellite towns. The municipal government's hope is that these satellite towns will become larger and more self-sustaining, with residents working in the local industry rather than commuting downtown. Vehicular traffic may continue to increase, but at least it will be more decentralized.

The Songjiang area of Shanghai, for example, has been designated as a base for the electronics industry. As a result of this policy, Songjiang is expected to house one million people in just a few years. The Shanghai Planning Museum, a fascinating combination of historical exhibits and chamber-of-commerce-style boosterism, portrays detailed plans for the development of outlying Chongming Island—the third largest island in China and a portion of Shanghai Municipality—as an environmentally friendly planned community.

Government compulsion sometimes is more direct. In the early years of the Pudong development, the municipal government aimed to transform the Lujiazui area into a center of banking and finance and the Jinqiao area into a residential nucleus for expatriates living in Shanghai. To this end, the government informed foreign banks that they could obtain business licenses only if their offices were physically located in Lujiazui. International schools received similar directives and were instructed to operate in Jinqiao. These efforts to control land use succeeded in accomplishing their goals. Lujiazui is rapidly becoming Shanghai's Lower Manhattan,<sup>62</sup> and the Jinqiao area now is home to approximately twenty international schools, which in turn serve as a magnet for foreigners. Similarly, the government indirectly financed Pudong's pioneer urban residents by selling land use rights at relative bargain prices. Not only was the government paying the huge costs of the massive infrastructure development needed in this previously rural region's early days, it also was subsidizing those considering moving to the area.

#### D. GOVERNMENT USE OF INCENTIVES

Developers sometimes need even stronger coercion because some projects simply are not economically feasible standing on their own. Two professionals separately explained to me how an

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62. A 1984 academic article on display at the "Pudong 15" exhibit at Pudong Exhibition Hall, which celebrates the fifteenth anniversary of the opening up of Pudong, is entitled, *Where is Shanghai's Manhattan?*

overseas Chinese developer was induced to spearhead the redevelopment of the older Shanghai neighborhood that is now the upscale Xintiandi shopping area. At the time the idea was first hatched, the developer believed the project to be infeasible. Shanghai's government sweetened the pot by offering this company additional choice land elsewhere in the city; the value of this extra property apparently was sufficient to change the developer's mind. Once again, the municipal government provided an indirect subsidy, and the market—goosed by these government incentives—got the job done.

Just as it may increase inducements when it wants an area to blossom, the government also can reduce incentives or coercion if it wishes for development in an area to cool. After fifteen years of encouraging or forcing development in Pudong, the Shanghai government appears to recognize that at least some sections of this area's real estate economy may have overheated. The district government of Pudong, which had been permitted to retain money raised from the sale of land use rights within the district for construction of infrastructure projects there, apparently will soon be required to remit this money to the Shanghai municipal government. The Pudong district government thus will have fewer resources available to channel development within the district, while Shanghai's municipal government will increase its ability to use profits from the sale of land use rights in parts of Pudong to target neighborhoods elsewhere in the municipality. In addition, the central and municipal governments have used tax policy and interest rate adjustments as a means of controlling the level of expansion of the real estate market more broadly.

#### E. CONFLICTS BETWEEN THE CENTRAL GOVERNMENT AND THE PROVINCES

The previous example illustrates the potential for conflict between the government of a municipality and the government of a district within that municipality. But an even larger problem is the possibility of disagreements between a province or a municipality and the central government. Many of the provinces and municipalities profit significantly from the granting of land use rights. These lower-level governments retain seventy percent of the proceeds from sales of land use rights, remitting the other thirty percent to Beijing.<sup>63</sup> Since there is no system of ad

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63. Tudi guanli fa [Land Administration Law] (promulgated by the Standing Comm. Nat'l People's Cong., June 25, 1986, revised Dec. 29, 1988, Aug. 29, 1998 & Aug. 28, 2004, effective Aug. 28, 2004), art. 55 (2004) (P.R.C.) [hereinafter Land Admin. Law].

valorem property taxation in China,<sup>64</sup> the municipalities fund a significant portion of their ongoing operations from the sale of land use rights. These government entities also benefit from the increased income taxes they can collect down the road if the land is ultimately used in a productive way. So it is greatly to the benefit of these lower-level government entities to keep the real estate market booming for as long as possible: The more land that developers want to buy and the higher the going price, the more money these government entities will collect to fund their ongoing operations and their massive capital expenditures.<sup>65</sup>

Although the central government receives its portion of the sale proceeds, it has its own reasons to fear unremitting land price appreciation. As urban residential prices continue to increase at a rate faster than that at which urban salaries are rising, there is growing concern that fewer and fewer of the urban residents who do not already own their homes will be able to afford to buy units, leading to unhappiness among those priced out of the residential real estate market. Meanwhile, if the urban real estate bubble ever bursts, those who have succeeded in buying their own homes and riding the residential real estate wave may not like where it deposits them. Either way, the government in Beijing enjoys only a small portion of the benefit of the real estate boom but will likely bear the brunt of any citizen unrest that might materialize from it.

The central government seems to be particularly concerned about the preservation of agricultural land.<sup>66</sup> The continued upswing in urban real estate markets threatens to dislocate peasants, and not just poorer urbanites, as cities expand inexorably into undeveloped neighboring agricultural property. The central government may be anxious about shortages of food in modern China, although the nation currently seems quite capable of feeding itself and exporting surplus food.<sup>67</sup> The government's larger

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64. While there is no general ad valorem property tax, certain similar taxes are levied on profit-making enterprises. Government revenues from these taxes appear to be relatively small. See Chengri Ding & Gerrit Knaap, *Urban Land Policy Reform in China's Transitional Economy*, in *LAND & HOUSING*, *supra* note 34, at 16 (describing proceeds of one of these taxes as "so minimal that they barely reflected land ownership").

65. See *id.* at 21–22 (noting that as much as half of some cities' revenues comes from the sale of land use rights).

66. See, e.g., Land Admin. Law, arts. 4, 22, 24, 31, 33–34 (2004) (limiting conversion of agricultural land for construction purposes).

67. Cf. George C.S. Lin & Samuel P.S. Ho, *China's Land Resources and Land Use Change*, in *LAND & HOUSING*, *supra* note 34, at 94 & n.11 (quoting a study finding that China's cultivated land provides 88 percent of China's food needs while acknowledging that figures such as this one are unreliable; the authors note that changes in dietary habits and farming technology might allow greater food production from less and less agricultural land); *id.* at 116 & n.28.

worry seems to be the enormous potential for unrest in rural areas if peasants continue to lose land without having alternative economic opportunities available to them.<sup>68</sup>

For rural residents, the land they cultivate is not just their livelihood, but also their social security. If these residents lose the use of the land they have been farming, the compensation they receive may allow them to afford a newer and more modern urban dwelling but probably will not provide them with an income during or after their working life. The ability of these former farmers to replace this income in an urban setting is likely to be limited.<sup>69</sup> And while several different people—including one lifelong inhabitant of Pudong—suggested to me that long-time residents of the formerly rural areas of Pudong are generally satisfied with the benefits that recent urbanization has brought, this does not seem to be the case throughout China's rural areas more broadly.<sup>70</sup> Beijing, understandably intent on squelching the next peasant revolution before it begins, has insisted that there be no net decrease in cultivable land.<sup>71</sup>

In a nation that abhors chaos more than it cares about the protection of individual liberties, this concern about upheaval may be the most important reason why the central government is trying to tamp down the real estate market.<sup>72</sup> But the government's ability to succeed in restraining market forces is limited. One expert informed me that the central government has placed quotas on sales of land use rights on a province-by-province basis. Provinces with booming real estate markets, however, have

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68. Professor Peerenboom notes, "Land disputes have become a major source of unrest in rural China and indeed throughout China. The Land Bureau is the leading defendant in administrative litigation suits, accounting for some 15 percent of all such cases." PEERENBOOM, *LONG MARCH*, *supra* note 2, at 482 (internal citations omitted).

69. One person I met with stated that compensation in these instances will include a lifetime income benefit, but others were more equivocal on this point. Several people indicated that former rural residents may qualify as urban residents after relocation, which will allow them to obtain certain social welfare benefits for which they previously were ineligible.

70. See, e.g., Howard W. French, *Villagers Tell of Lethal Attack by Chinese Forces on Protesters*, N.Y. TIMES, Dec. 11, 2005, § 1, at 3 (describing dispute over compensation for the use of residents' land in which security forces killed as many as 20 residents of the village of Dongzhou in "the deadliest use of force by Chinese forces against citizens since the Tiananmen massacre in 1989"; the article notes that residents compared the behavior of police to that of "Japanese occupiers of the last century" and the "Chinese Nationalist Army of Chiang Kai-shek").

71. See RANDOLPH & LOU, *CREL*, *supra* note 10, at 25–28.

72. *But see How to Make China Even Richer*, THE ECONOMIST, Mar. 25, 2006, at 11 (suggesting that "it is the absence of reform that is proving destabilising, as peasants protest violently against land seizures by local governments keen to exploit the land themselves."). In other words, it is possible that peasants would gladly accept compensation for their land if the amount they received more accurately reflected the land's true value on the open market.

been permitted to purchase unused quota from other areas. This overall process does serve to spread the wealth somewhat, with booming locales such as Shanghai having to send some money to less vigorous places such as Inner Mongolia in exchange for additional development quota. But it probably does not succeed in reducing development in the more successful provinces to the extent the central government may have hoped.

Interestingly, another expert, from another part of China, questioned whether transfers of quota were permissible. This second expert concurred, however, that the entire effort at limiting real estate development is difficult for the central government to police. One professional informed me that the central government has been taking satellite photos of agricultural areas on a regular basis and examining them to confirm that cultivable land is being used for agricultural purposes throughout the growing season and is not being used in other ways without the knowledge of the central government.

Although Beijing theoretically controls the nation's land market, lower levels of government have economic incentives to see that market continue to blossom. These municipal and provincial governments profit greatly from the initial transfer of land use rights and continue to benefit by imposing taxes on subsequent property transfers and income taxes on businesses that operate on this land. Lower levels of government have their reasons for wanting to see the boom continue, and they use their substantial control over local real estate markets to encourage continued growth.

## V. CLEARING THE LAND: DEMOLITION AND RESETTLEMENT

### A. CHINA'S SHORTAGE OF DEVELOPABLE LAND

The land mass of China is almost exactly the same size as that of the United States, but China has more than four times the population.<sup>73</sup> A much larger proportion of China's land area consists of deserts and rugged mountains that are thinly populated and likely to remain that way. China's interior areas are much less accessible by ship or by rail than are those in

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73. The CIA website lists China's area as 9,596,960 square kilometers and its 2006 population as 1,313,973,713, CIA, *The World Factbook – China*, available at <https://www.cia.gov/cia/publications/factbook/geos/ch.html> (last visited Mar. 7, 2007); comparable numbers for the United States are 9,631,418 square kilometers and 298,444,215 people, CIA, *The World Factbook – United States*, available at <https://www.cia.gov/cia/publications/factbook/geos/us.html> (last visited Mar. 7, 2007).

America.<sup>74</sup> So it is no wonder that the eastern part of China is thickly inhabited and that there is little or no unused land in that portion of the country—even rural areas are densely packed by American standards.<sup>75</sup> As a result, it is difficult to find a desirable site for any new project in or near China's eastern cities that will not require the relocation of existing residents, sometimes in large numbers. Either the government or the developer must relocate these residents, some of whom are likely to object strenuously. Real estate developers naturally prefer to work with vacant land whenever possible, but vacant land is hard to come by.

## B. DEMOLISHING STRUCTURES AND RESETTLING RESIDENTS

The process of relocating current occupants of property and demolishing existing structures is a complex and expensive one. It has changed over time. And like everything else in China, it arises from a combination of a small portion of written law and a larger measure of interpretation by government officials with much discretion.<sup>76</sup> The topic of demolition and resettlement is sufficiently complex that I intend to address it in far greater detail in another article. But a brief summary of the relocation process is necessary here, as demolition and resettlement comprises such an important piece of so many real estate developments in China today.<sup>77</sup>

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74. "More than 20 percent of [China's] land (e.g., deserts and land covered by glaciers and/or snow) is unusable for any purpose; mountainous areas comprise another 30 percent of China's territory." Chengri Ding & Gerrit Knaap, *Urban Land Policy Reform in China's Transitional Economy*, in *LAND & HOUSING*, *supra* note 34, at 13 (2005). As a result, "China feeds more than 20 percent of the world's population on less than 7 percent of the world's farmland." *Id.* Note, though, that statistics about the Chinese economy tend to be extremely unreliable, particularly when they are furnished by Chinese government agencies. See, e.g., George C.S. Lin & Samuel P.S. Ho, *China's Land Resources and Land Use Change*, in *LAND & HOUSING*, *supra*, at 89 & n.1 (quoting three different recent estimates of cultivated land in China that vary from 94.97 to 160 million hectares).

75. See, e.g., Jean Jinghan Chen & David Wills, *Introduction*, in *LAND, PROPERTY AND CONSTRUCTION*, *supra* note 5, at 5 (estimating that over 90% of China's population lives in the eastern third of its land mass); George C.S. Lin & Samuel P.S. Ho, *China's Land Resources and Land Use Change*, in *LAND & HOUSING*, *supra* note 34, at 92 (estimating that "more than 40 percent of the Chinese people live[] in East China on less than 14 percent of the country's total land area").

76. To the extent that written laws apply, they are not always readily accessible. See, e.g., PEERENBOOM, *LONG MARCH*, *supra* note 2, at 246 (noting, "The lack of centralized records makes it difficult to know exactly what rules apply at any given time in any given place") (internal citations omitted). And even when applicable written laws are available, they may be vague, as is often the case in other civil law countries. *Id.* at 251.

77. For an excellent treatment of some of the problems with the current process of demolition and relocation, see Chenglin Liu, *Informal Rules, Transaction Costs, and the Failure of the "Takings" Law in China*, 29 *HASTINGS INT'L & COMP. L. REV.* 1 (2005) [hereinafter Liu, *Informal Rules*].

All land in China technically is owned either by the state or by agricultural collectives.<sup>78</sup> However, because the state has the power to expropriate land from agricultural collectives, the collectives own their land at the mercy of the state,<sup>79</sup> and the state has shown over the past decade that it is willing to requisition agricultural land if it believes the land can be put to uses that are more economically productive. The Chinese government thus effectively owns or controls all domestic land. Individuals or business entities may acquire land use rights from the government for terms ranging up to seventy years and then may own a structure or unit on that land.<sup>80</sup>

In urban areas, many of the residents living in older units probably do not own either the units themselves or the underlying land use rights.<sup>81</sup> Most likely, their housing has been provided to them by the government, their work unit, or, occasionally, an agricultural collective that owns some land that has become urbanized. These units are likely to be extremely old and run-down.<sup>82</sup> The occupants are entitled to compensation if the government forces them to relocate. But as expert after expert emphasized to me, the amount they will receive—reflecting the two realities of non-ownership of the land use right and poor condition of the structure—will be minimal.

If the overall value of a housing unit is defined to include both the value of a land use right to the land and the value of the unit located on that land, one expert estimated for me that in a typical requisition of this sort, the land use right represents 20%

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78. In accordance with Marxist doctrine, individuals are not permitted to own land in China. Keith McKinnell & Anthony Walker, *China's Land Reform and the Establishment of a Property Market, in LAND, PROPERTY AND CONSTRUCTION*, *supra* note 5, at 31 ("According to Marxist theory, land is singled out as incapable of being regarded as a commodity, since it is not a product of man's labour - land exists by itself.").

79. PRC Constitution, art. 10 (2004). See RANDOLPH & LOU, CREL, *supra* note 10, at 59 & nn.1–2, 73–74 & n.47. The central government may exercise ownership rights directly or may act through county and city governments as its surrogates. It is generally these local-level governments that grant land use rights. *Id.* at 68–69.

80. See *infra* Part VI.

81. Chinese law appears to recognize "homestead" rights in free-standing houses, although the legal status of these homestead rights is somewhat murky. Homestead rights are not applicable to units in multiple-dwelling buildings, which is where most urban Chinese live. See RANDOLPH & LOU, CREL, *supra* note 10, at 107–10.

82. Those urban occupants who have become owners are likely to own newer and more modern units that were constructed after land use rights became marketable. These units, which are more valuable and more recently constructed, are far less likely to be redeveloped—for the second time in the last ten or fifteen years—than are older and shabbier units that usually are not owned by their occupants. At the same time, some older units are now being sold or rented to their occupants rather than being provided by work units as a benefit to their workers. These units generally are less valuable and in poorer condition.

of this overall value while the structure represents the other 80%. So the resident who is displaced may receive 80% of the overall value of an old unit and then have to purchase 100% of the value of a newer and more expensive unit, with the percentage increase reflecting the fact that the buyer now must purchase the land use right as well as the unit built on it.

Given the poor quality of much of the older housing stock in urban areas, residents may be all too happy to take this money—either negotiated with the developer or forced on them by the government—and move to a more inviting dwelling. In some cases, occupants who settle with the government quickly receive compensation bonuses of as much as 20%; in this way, the government hopes to induce potential holdouts to take the larger sum early and relocate without a fight. But even with any settlement bonus, the amount of compensation they are likely to receive will seem modest in today's competitive real estate market and probably will require them to relocate to less expensive outlying areas of their city.<sup>83</sup> Moreover, as a result of rapid price appreciation, the longer these buyers wait to buy their new unit, the less they will be able to afford.

In the earlier days of China's new housing market, which is to say a decade ago, the government typically paid compensation in kind, providing relocatees with new apartments. Today, with a more mature residential real estate market, a citizenry that has quickly become more sophisticated about investing in residential real estate, and a wider range of apartments available, these relocatees are more likely to receive cash compensation, which allows them greater personal choice of where to live. Either way, the overall result of the relocation process in urban areas seems to be the gradual displacement of poorer, long-time urban residents to more modern housing on the outer fringes of the city, and their replacement downtown by more affluent purchasers who can afford the rapidly increasing prices of homes in the urban center.<sup>84</sup> In short, Chinese metropolitan areas seem to dis-

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83. "It's very good. Now I have five rooms. I have a kitchen and a toilet—before we just used a chamber pot . . . It's a little far, but I like it." YATSKO, *NEW SHANGHAI*, *supra* note 4, at 33 (quoting a former downtown resident forced to relocate to a Shanghai suburb after her original neighborhood was redeveloped). The author continues by noting that this resident's feelings are not universally shared by relocatees. *Id.* at 34–36.

84. The amount of housing that is being developed or redeveloped in China today is astonishing. According to one Chinese publication, "Housing construction in urban and rural areas averaged 860 million square meters a year between 1985 and 1992. The peak year of 1988 saw more than 1 billion square meters of housing completed." *THE CHINESE ECONOMY INTO THE 21ST CENTURY: FORECASTS AND POLICIES* 137 (Li Jingwen ed., 2000). This same publication lists the average living space per person in 1992 as 18.9 square meters for rural residents and 6.9 square

play characteristics that are the exact opposite of those of many of their American counterparts, in which more affluent residents have tended to move to the suburbs, abandoning the urban core to the poor.

### C. TRANSFERRING CLEARED LAND TO DEVELOPERS

Once the government has removed the existing occupants from the land, it is in a position to transfer it to a developer. The price the government can charge for land use rights on this newly vacated land will reflect its, and the market's, assessment of what can now be built on the land and the ultimate rentable area of the project. In addition, the government has succeeded in driving the price higher by going to the expense and inconvenience of demolition and resettlement. As one expert stated to me, "[The] land price is higher for clean land." The government presumably profits greatly by taking the land at a price that reflects its then-current use and conveying land use rights for more intensive uses at current market rates to developers who plan to construct higher-end housing or commercial projects.<sup>85</sup> By exercising its powers to remove the current users of the property, assemble large development parcels, and allow more intensive uses and densities, the government can enrich itself enormously, a fact that many observers, along with some displaced residents, find extremely troubling.<sup>86</sup>

In the earlier days of the modern Chinese real estate market, however, the government occasionally was willing to bear much of the business risk of a relocation and demolition project itself. For example, if a high-profile foreign company wanted to invest in specific land to build a manufacturing facility, it might contract with the government for that parcel, to be delivered vacant at a specified date in the future. The government then would ap-

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eters for urban residents, *id.* at 182–83, which suggests that in excess of 350 million Chinese are living in housing built during that single eight-year period. These staggering numbers are consonant with China's goal of improving housing conditions for all Chinese citizens. *See, e.g.*, Law on Admin. of Urban Real Estate, art. 4 (1995) ("The State shall . . . support the development of construction of residential houses so as to gradually improve the housing conditions of residents.").

85. While most of the experts with whom I raised this issue either stated or implied that this is the case, one Chinese lawyer strenuously disagreed with this assertion.

86. Of course, there is the possibility that the government will lose money if property values decrease during the relevant time period. However, land prices in China seem to have increased relentlessly during the past fifteen years. Besides, real estate values would have to drop precipitously before the decrease would offset the government's built-in advantage in buying out occupants of run-down homes (many of whom do not hold land use rights) and assembling large development parcels that can thereafter be developed for more intensive uses by commercial developers (all of whom will hold land use rights in this same property).

proach the occupants and seek to relocate them at a negotiated price. This process obviously entailed great risk to the government, as it would have already committed to a sales price before knowing the actual cost of buying out the existing occupants. The government presumably believed it would benefit in the long run, in the form of higher tax revenues and increased economic development in the area, even if it lost money on the specific real estate transaction. This sequence of events has become far less common as the Chinese real estate market has matured, the government has gained experience, and outside buyers have become more anxious to acquire rights to develop land in China.

Several speakers emphasized that the government has become considerably more reluctant during the past few years to requisition older homes for private commercial development, whether before or after identifying the eventual developer for the land. This hesitancy reflects the government's concerns about both business risk and public perception. Existing residents have grown savvier about holding out for higher compensation, and the government has been encouraging would-be developers to deal with these holdouts directly, especially when the number of holdouts is non-trivial. This shift places the financial hazard of ever-more-expensive buyouts on the developer rather than on the government. If the deal balloons in price or falls through completely, it is no longer the government's problem. A number of blocks in Shanghai were obviously on their way to being redeveloped, but with an occasional building still standing, presumably occupied by a resident who had not yet reached final agreement with the block's developer. Private developers, meanwhile, sometimes acting through intermediary relocation companies, have occasionally resorted to intimidation and violence as a means of encouraging these residents to reduce their demands and leave quickly. In one recent Shanghai incident described for me by several different interviewees, a couple was killed when their apartment was set on fire in an apparent attempt to scare them into leaving.<sup>87</sup>

Moreover, while the government still technically holds the right to requisition this land, public pressure has made these requisitions more and more unpopular. At a time of increasing real estate prices and widespread worry about housing costs, the government does not wish to be perceived as assisting real estate developers in enriching themselves by depriving poorer residents

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87. Liu, *Informal Rules*, *supra* note 77, at 2 & n.5.

of their long-time homes.<sup>88</sup> Several of the experts who shared their views on this topic with me expressed sympathy for the plight of these poorer urban residents, along with concerns that overall social instability might increase if these controversial land requisitions continue.<sup>89</sup> Nonetheless, many who are knowledgeable about the Shanghai real estate market believe that the government continues to assist real estate developers actively, sometimes employing illegal techniques to do so.<sup>90</sup>

#### D. SHANGHAI'S LAND RESERVE SYSTEM

Shanghai's government recently has instituted a land reserve system. Under this system, the government will relocate urban residents from a block before a developer has been identified and will stockpile this urban land. When the government later chooses to release this land from its reserves, it will allow developers to bid for it competitively. The government establishes a minimum price that allows it to recoup its earlier demolition and relocation costs, although market-driven bids are likely to exceed this minimum by a substantial amount, particularly if some time has elapsed between the acquisition and the sale. This has become the most common method of assembling land in Shanghai today. The land reserve method allows the government, rather

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88. Some of the older buildings slated to be razed may have historical value as well. There is growing, if still slight, support in China for historic preservation of significant structures.

89. Even when the purpose of a land requisition is unquestionably public, the removal of a resident from their home is controversial. Chinese citizens have protested publicly in front of government ministries and there have been cases of self-immolation in Beijing. See, e.g., *Farmer Sets Self on Fire at Tian'anmen Square*, CHINA DAILY, Sept. 15, 2003 (describing farmer as dissatisfied with relocation decision; article does not address legitimacy of farmer's claim), available at [http://www.chinadaily.com.cn/en/doc/2003-09/15/content\\_264285.htm](http://www.chinadaily.com.cn/en/doc/2003-09/15/content_264285.htm) (last visited Mar. 7, 2007). See also Liu Li, *City Denies Reports on Large-scale Evictions*, CHINA DAILY, Mar. 11, 2004 (claiming that controversial evictions "are in tune with the capital city's long-term development, and are not merely for the Beijing 2008 Olympic Games"), available at [http://www.chinadaily.com.cn/english/doc/2004-03/11/content\\_313666.htm](http://www.chinadaily.com.cn/english/doc/2004-03/11/content_313666.htm) (last visited Mar. 7, 2007).

Requisitions for purposes that are less obviously public raise even greater worries for the government. This distinction mirrors the public outcry over takings for economic development in the United States. See *Kelo v. City of New London*, 545 U.S. 469 (2005) (holding that takings for purposes of economic development do not violate the "public use" requirement of the Fifth Amendment). I was in Shanghai both before and after the Supreme Court decided *Kelo*, and my faculty colleagues were following the case with great interest. Several of the experts I interviewed in connection with this Article asked me extremely knowledgeable questions about *Kelo*, with which they were quite familiar.

90. See, e.g., Joseph Kahn, *Shanghai's Party Leader, Mistrusted by Hu, Is Purged*, N.Y. TIMES, Sept. 26, 2006, at A8 (reporting on mixed motives for ousting Chen Liangyu, Communist Party leader of Shanghai, including accounts that he had profited from illegal real estate activities).

than the developer, to take the initiative on land use planning. It also divorces the process of requisitioning older housing stock from the subsequent conveyance of the vacant land to a particular developer, a separation that may help to insulate the government from the charge that residents are being relocated at the behest of a specific developer.

### E. AGRICULTURAL COLLECTIVE LAND

Agricultural collective land poses a knottier problem, since neither the agricultural collective itself nor the government may grant land use rights to developers or homeowners on this land. The government first must requisition it and convert it to state-owned land before the government can grant land use rights on it.<sup>91</sup> In this sense, China's dual land market differs significantly from that of the United States, in which there is a unitary market. While the agricultural collective generally is entitled to compensation for its land when it is converted into state-owned land, it is difficult to determine what rural land actually is worth since there has been no true market in agricultural land in China for more than half a century. Agricultural collective land also can be requisitioned by the government and then granted back to the collective in the form of a granted land use right. This process allows the collective either to use the land for non-agricultural purposes itself or to re-transfer the granted land use right to a third party and enjoy the profit from its increased value for development purposes.<sup>92</sup>

Many of the people I met with argued that the government is paying unfairly low amounts to the collectives for their farmland, by which they meant that the government is calculating fair market value on the assumption that the highest and best use still is agricultural.<sup>93</sup> The collectives then typically provide the dis-

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91. Law on Admin. of Urban Real Estate, art. 8 (1995) ("The land-use right for the collective-owned land within a planned urban district may be granted with payment only after it is requisitioned in accordance with the law and turned into State-owned land").

92. RANDOLPH & LOU, CREL, *supra* note 10, at 134-35, 145-46. After Chinese law began to recognize granted land use rights, allocated land use rights were defined as land use rights that a user obtained free of charge. *Id.* at 86. Allocated land use rights ordinarily have an indefinite term as long as the stated use for which the right was granted continues. Law on Admin. of Urban Real Estate, art. 22 (1995); RANDOLPH & LOU, CREL, *supra*, at 91. The indefinite term and lack of required consideration characteristic of an allocated land use right reflect its origin as part of the socialist planned economy. *Id.* at 89.

93. Article 47 of the Land Administration Law provides that compensation for requisitioned agricultural collective land shall be equal to six to ten times the average annual crop output during the preceding three years, plus additional amounts for resettlement, fixtures, and crops not yet harvested. Land Admin. Law, art. 47 (2004). Provincial and lower-level governments may increase these totals to main-

placed farmers with either cash or in-kind compensation; in some cases, the farmers may be relocated to other collectives. Once the land has been transferred from the collective to the state, the government then can grant land use rights on it to developers at much higher prices—values that now reflect the fact that residential or commercial development has become the new highest and best use.

In short, the government is profiting, at the expense of agricultural peasants, from changing patterns of land use and its own unique power to transform undevelopable farmland into developable urban land.<sup>94</sup> This process roughly mirrors the method for clearing urban land that is occupied by older housing, with the added complication that the displaced residents are farmers and thus are losing their livelihood as well as their home.<sup>95</sup> Sev-

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tain living standards, but the adjusted total for land compensation and resettlement expenses may not exceed thirty times the average annual crop output during the preceding three years unless the State Council raises the rates due to special circumstances. *Id.* (2004). These valuation options all reflect what the land is worth as farmland and not the fair market value as determined by a negotiated transfer between willing participants. If the prospective buyer expects to develop the land more intensively, the land almost certainly is worth considerably more to this buyer than its value as determined by Article 47.

94. See, e.g., Anthony Gar-on Yeh, *The Dual Land Market and Urban Development in China*, in *LAND & HOUSING*, *supra* note 34, at 43 (“Because the municipality monopolizes the supply of this type of land, it can acquire rural land from farmers at a monopolistic price and sell it to developers at market price. A municipality can make a considerable profit because of the great difference between land-acquisition and land-lease prices.”); William Valletta, *The Land Administration Law of 1998 and Its Impact on Urban Development*, in *LAND & HOUSING*, *supra*, at 67 (“In many requisition deals a large windfall of new value resulted from the reclassification of the land [from rural to urban]. The requisition procedure was designed to capture all of this value for the state or municipality.”).

General concerns about the upheaval that might be caused by the loss of agricultural land to real estate development appear to have led to the amendments to the Land Administration Law that became effective in 1999. *Id.* at 69. These changes require comprehensive land use planning at all levels of government and make it more difficult for lower-level government entities to modify permitted land uses. Land Admin. Law, arts. 8, 12, 17–20, 24 (2004); RANDOLPH & LOU, *CREL*, *supra* note 10, at 136–38.

95. Keep in mind that in the United States, 0.7% of the labor force is engaged in “farming, forestry, and fishing,” CIA – The World Factbook – United States, *available at* <https://www.cia.gov/cia/publications/factbook/geos/us.html> (last visited Mar. 7, 2007), while in China, the percentage of the labor force engaged in “agriculture” is 45%, CIA – The World Factbook – China, *available at* <https://www.cia.gov/cia/publications/factbook/geos/ch.html> (last visited Mar. 7, 2007). Even if these categories are not defined in precisely the same way, it is clear that a vastly higher proportion of the Chinese population leads a life that revolves around agricultural production. And the education, literacy, and social gaps between urban and rural dwellers are much greater in China than in the United States.

Over the next two decades, as many as 300 million Chinese may move from rural areas to cities. Chengri Ding & Gerrit Knaap, *Urban Land Policy Reform in China's Transitional Economy*, in *LAND & HOUSING*, *supra* note 34, at 32. These approximate numbers were confirmed for me by numerous real estate professionals

eral different experts advised me that disagreement over how to handle the ongoing problem of compensating farmers fairly is largely responsible for the delay in the adoption of China's in rem property law, which has been under discussion for years.<sup>96</sup>

Even more worrisome to those concerned about the unfairness of these relocation policies is the fact that the profits the government extracts from the agricultural collectives often are used to fund government operations that primarily benefit the urban core. Some professionals bluntly view this process as a transfer of wealth from poor peasants living in outlying collectives to wealthy downtown city dwellers. Furthermore, agricultural workers, who are not considered urban residents and therefore do not qualify for certain social welfare benefits, typically depend on the regular production from their agricultural collective land as their retirement fund. The central government worries that these facts, combined with the growing income disparity between the booming eastern cities and the lagging agricultural areas, will increase the level of peasant unrest.<sup>97</sup>

One expert suggested that more and more developers today are being forced to negotiate directly with the collectives rather than acquiring land from the government after the government has obtained the land from the collectives. The government, while still nominally required to serve as intermediary, plays a more passive role than it formerly did. Another knowledgeable person advised me that Shanghai is undertaking a pilot study that would allow agricultural collectives to trade land use rights in certain urban zones, a transaction structure that apparently

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with whom I spoke. One of these experts noted to me that while greater freedom of movement is likely to reduce disparities of wealth among different regions of China, it also is likely to create enormous social upheaval along the way, and for many decades to come.

96. Subsequent events in China have confirmed this view. See Joseph Kahn, *A Sharp Debate Erupts In China Over Ideologies*, N.Y. TIMES, Mar. 12, 2006, at A1 (describing the 2006 shelving of the proposed property law by the National People's Congress because some scholars and advisers fear "China's rising income gap and increasing social unrest" and noting that some Chinese economists view peasants as "economically disenfranchised").

97. One lawyer stated that some of these peasants actually receive income for life in exchange for the loss of their land; another expert explained that these farmers are given jobs as a form of supplementary non-cash compensation. Still another expert advised me that if an entire agricultural collective is converted to state-owned land, the displaced farmers become urban residents, which makes them eligible for retirement benefits, health care, and unemployment insurance.

The Chinese government recently announced that it will experiment in certain provinces by abolishing the legal distinction between urban residents and peasants. See Joseph Kahn, *China to Drop Urbanite-Peasant Legal Differences*, N.Y. TIMES, Nov. 3, 2005, at A8 (stressing government's efforts to "slow the country's surging wealth gap and reduce social unrest").

places the collective in a position to retain more of the gains from transferring rights to developable land.

In these evolving settings, developers will have to reach their own accords with collectives, which presumably are learning to hold out for prices that reflect the new highest and best use for their land. Developers pass these costs along to the ultimate purchaser, but now the premium indirectly benefits the rural residents who have been displaced. This process is similar to the one the government now seeks to enforce when resettling poor residents of urban areas.

In an effort to cool down the real estate market while reducing the number of peasants who end up without land to cultivate, the central government recently has enforced land preservation plans that place strict limits on the amount of arable land that can be converted to more intensive uses.<sup>98</sup> Developers must either replace the land themselves or contribute to a fund that is used to replace the land or reclaim previously unusable land.<sup>99</sup> The central government, which is more concerned with maintaining overall social stability, once again finds itself directly at odds with provincial and municipal governments, which rely on habitual sales of land use rights to fund their operations.

#### F. THE CONTINUING NEED FOR DEVELOPABLE LAND

The obvious conclusion that any observer reaches is that a sensible developer would rather build on land that is already thinly populated than obtain rights to land which it will have to persuade numerous residents to leave. This conclusion helps to explain the popularity and success of locales such as Shanghai's Pudong New Area, where the few prior residents could be relocated inexpensively.<sup>100</sup> Demolition and resettlement costs are far

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98. See Land Admin. Law, arts. 31–42 (2004) (requiring conservation of agricultural land, preservation of topsoil, re-use of “wasteland,” and other similar preservation measures).

99. One expert referred to this reclamation process as “turning mud into agricultural land.” It turns out that he really meant it: One method of providing replacement land is to shore up muddy areas in the ever-growing Yangtze River Delta, not far from Shanghai. He expressed concern that the new Three Gorges Dam, which has begun to reduce the amount of silt that flows downstream and collects in the delta, may diminish the amount of mud available for reclamation. Other experts question the effectiveness of land reclamation, noting that reclaimed land often is less fertile than the corresponding land lost to agriculture and that reclamation of marginally fertile land may have negative environmental effects. George C.S. Lin & Samuel P.S. Ho, *China's Land Resources and Land Use Change*, in *LAND & HOUSING*, *supra* note 34, at 118.

100. Pudong's development also was hastened by tax incentives, excellent new infrastructure, and some rather heavy-handed government pressure. See *supra* note 62 & accompanying text. It was not just developers who wanted this massive project to succeed but also the Chinese government at all levels.

lower, which translates into greater profits and greater ease for the developer and lower costs for the end user.

Several of the experts I spoke with argued that China's vast stock of government- and collective-owned land ensures that the Chinese economy will not collapse any time soon, as some Western experts have nervously predicted.<sup>101</sup> The government can simply keep transferring land use rights on the ever-expanding urban fringe<sup>102</sup>—land that it either owns already or can easily acquire from agricultural collectives—at hefty prices that reflect the land's increasing value for urban residential or commercial use. These experts argue that as long as the government has land use rights that it can sell, it will never run out of cash.<sup>103</sup>

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101. Cf. STUDWELL, *CHINA DREAM*, *supra* note 49, at 260 (“Confronted with an insolvent banking system, a rising budget deficit and unfunded welfare liabilities, the reaction of ministers is to claim that the state owns all kinds of valuable assets [including land] that it can sell to cover its expenditures.”). Studwell continues by disagreeing with this argument, but most of the Chinese professionals I met do not share his skepticism.

102. “Given that cities generate more than 70 percent of the country's economic output, China's economic success inevitably fuels demand for land at the urban fringes, where economic development activity is most intense.” Xiaochen Meng & Yanru Li, *Urban Land Supply in the Chinese Transitional Economy: Case Studies in Beijing and Shenzhen*, in *LAND & HOUSING*, *supra* note 34, at 125.

China's cities are growing physically larger at a shocking rate. The average amount of space per resident is on the rise, cities are increasing the amount of public space such as parks, and tens of millions of rural residents are migrating to the cities—often without work permits—in search of jobs. An exhibit I viewed at the Shanghai Planning Museum states that in the past twenty years, Shanghai has razed 4.281 million square meters of blighted housing and replaced it with 16.2 million square meters of new housing. The same exhibit states that Shanghai's average per capita green space grew from 2.41 square meters to 9.15 square meters between 1997 and 2003. During this time period, the official population has been relatively stable and the unofficial population has been growing steadily. This museum also touts the advantages of some specific new suburban developments that are being built along the city's urban boundary. With more people and more space per person than ever, Shanghai is expanding both upward and outward, devouring land along the way.

103. One of the Chinese experts I met contrasted China's slow and smooth approach with that employed after the disintegration of the Soviet Union by Russia, which disposed of state-owned assets at a much more rapid rate. By selling off state-owned assets—including land—at a more measured speed, China not only preserved its assets for future use or sale but also retained greater control over the ultimate use of these assets for a longer period of time. See also Bo-Sin Tang & Sing-Cheong Liu, *Property Developers and Speculative Development in China*, in *LAND & HOUSING*, *supra* note 34, at 201 (“In contrast with many Eastern European countries, China did not pursue full-prong privatization or ‘shock therapy’ in its reform process. Instead, it pursued incremental changes, thereby decreasing the likelihood of major social instability.”). Cf. PEERENBOOM, *LONG MARCH*, *supra* note 2, at 460 (arguing that Russia's poor experience with privatization reflects the fact that it sought to privatize in the absence of rule of law and at a time when its institutions were weak).

## VI. THE LAND USE RIGHT

### A. THE LEGAL BASIS FOR THE LAND USE RIGHT

In 1988, China amended Article 10 of its Constitution to read, “The right to the use of land may be transferred in accordance with the law.”<sup>104</sup> While this provision does not permit the private ownership of land,<sup>105</sup> it does allow the government to grant land use rights for a specific term.<sup>106</sup> By clarifying that private citizens could not actually own the land itself, the Constitution “avoided abandoning the Marxist principle of state ownership”<sup>107</sup> while simultaneously creating an opportunity for a

104. PRC Constitution, art. 10 (2004).

105. The sentence immediately prior to the one just quoted, which dates back to the original 1982 adoption of this Constitution, was retained with only conforming changes and now reads: “No organization or individual may appropriate, buy, sell or unlawfully transfer land in other ways.” *Id.* (2004). See also Ming fa tong ze [General Principles of the Civil Law] (promulgated by the Standing Comm. Nat’l People’s Cong., Apr. 12, 1986, effective Jan. 1, 1987), art. 73 (1987) (P.R.C.) (stating that “[s]tate property shall be owned by the whole people” and that “[s]tate property is sacred and inviolable”). The first two sentences of Article 10 of the Constitution indicate that urban land is owned by the state and that rural and suburban land is owned either by the state or by collectives. Taken together, these provisions make it clear that all land is state- or collective-owned, but that the state now is constitutionally empowered to transfer the right to use land. The legal status of land use rights was further buttressed by a constitutional amendment in 2004. The new language states that the government must provide compensation when it expropriates land. PRC Constitution, art. 10 (2004) (“The state may in the public interest expropriate or take over land for its use in accordance with the law and provide compensation.”).

106. The Land Administration Law reflects these constitutional changes and provides more specificity. See, e.g., Land Admin. Law, art. 2 (2004) (“No units or individuals may encroach on land or illegally transfer it through buying, selling or other means. However, the right to the use of land may be transferred in accordance with law.”).

Prior to the 1988 constitutional change, some jurisdictions had experimented by leasing the right to use land to private entities. To the extent these precursors to the land use right were legally binding at all, they were enforceable only as contract rights; not until the 1988 constitutional amendment could users of property obtain more stable real estate rights. Professor Chen cites this as an example of a phenomenon that is fairly common in modern China: the rapid implementation of desirable new policies that lack any basis in the law existing at the time, followed by the law playing “catch-up.” CHEN, INTRODUCTION, *supra* note 24, at 117–18.

In a legal system evolving as rapidly as China’s, it is nearly impossible for policies and laws to develop with precise synchronicity. Moreover, local government officials likely were taking advantage of the pre-1988 legal uncertainty to benefit themselves. See XIN, CHINESE LEGAL SYSTEM, *supra* note 29, at 398 (discussing the corruption that the 1988 amendments may have been designed, at least in part, to mitigate).

107. LUBMAN, BIRD IN A CAGE, *supra* note 8, at 184. Subsequent changes to the Chinese Constitution reflect this tense dichotomy between private ownership and Marxist principles. For example, Article 6 was amended in 1999 by the addition of the following sentence: “In the primary stage of socialism, the State adheres to a basic economic system in which the public ownership is dominant and diverse forms of ownership develop side by side, and upholds a distribution system in which distri-

private real estate market to flourish.<sup>108</sup> The government may transfer land use rights to residential property for a term of up to seventy years. For commercial property, the maximum term is forty years. Industrial and other types of land use rights may not be granted for terms in excess of fifty years.<sup>109</sup>

The initial holder of a granted land use right ostensibly is required to develop the land within two years.<sup>110</sup> Many people, however, indicated to me that this rule is frequently ignored; in one expert's straightforward opinion, "Every policy in China, you can change!" Rights holders may pay an additional fee to extend the term beyond two years, may initiate minimal construction before the two-year period expires as a means of formally meeting the use-it-or-lose-it requirement, or may seek extensions of this two-year term, which generally have been readily available. One person, however, noted that the Shanghai government has hinted that it may begin to enforce the two-year rule more strictly, as a means of slowing the overheated real estate market and reducing the ability of investors to speculate on land use rights in undeveloped land.<sup>111</sup>

The Chinese granted land use right should not be confused with the ground lease familiar to Western real estate lawyers. The two devices demonstrate considerable differences.<sup>112</sup> Land-

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bution according to work remains a dominant form and a variety of other modes of distribution co-exist." PRC Constitution, art. 6 (2004). See also Chengri Ding & Gerrit Knaap, *Urban Land Policy Reform in China's Transitional Economy*, in LAND & HOUSING, *supra* note 34, at 14 ("As a milestone in the evolution of the Chinese Constitution, the 1988 amendment is significant, because it allowed the state to maintain ownership and at the same time promoted land market development without provoking political turmoil.").

108. For a discussion of the extent to which this increased security of land tenure may lead to sustainable economic growth, see Joyce Palomar, *Contributions Legal Scholars Can Make to Development Economics: Examples from China*, 45 WM. & MARY L. REV. 1011 (2004). Cf. Donald C. Clarke, *Economic Development and the Rights Hypothesis: The China Problem*, 51 AM. J. COMP. L. 89 (2003) (discussing relative importance of security of property and enforcement of contract rights).

109. While the constitutional amendment authorized the granting of land use rights, the State Council established the durational limits by regulation. RANDOLPH & LOU, CREL, *supra* note 10, at 127-28.

110. Law on Admin. of Urban Real Estate, art. 25 (1995) (imposing a penalty of up to twenty percent of the fee paid for the land use right if the land is not developed within one year and providing for forfeiture of the land use right if the land is not developed within two years).

111. In the short run, stricter enforcement of this rule might lead to more development, as rights holders whose two-year terms are nearing expiration begin construction they might otherwise have deferred. But in the long run, those considering purchases of land use rights for future construction might be inclined to wait if they fear that their rights will expire before they are ready to use them. If demand for land use rights began to dry up, prices presumably would drop.

112. See RANDOLPH & LOU, CREL, *supra* note 10, at 18-19 (expressing belief that Chinese land use right is derived from German civil law concepts and not from common law ground lease).

lord-tenant law generally does not apply to land use rights.<sup>113</sup> The price for the land use right is paid entirely in advance, which is rarely the case with a ground lease, and the grantee may not register the land use right until it has paid the entire fee.<sup>114</sup> The land to which use rights are granted must be developed within a fixed amount of time or the right is forfeited, as just noted.

The initial and subsequent non-government holders of land use rights may further transfer them within certain limits.<sup>115</sup> For example, in the case of residential land, the initial holder of the right is theoretically precluded from “flipping” the right to a second holder until the initial right holder has completed at least 25% of the proposed construction.<sup>116</sup> One scholar who mentioned this requirement to me also noted, however, that this rule is widely disregarded, with enforcement often obscured by confusion as to exactly how much construction has been completed. The holder of the land use right also must own the building constructed on that land.<sup>117</sup> In addition, some speakers told me that in parts of China, the purchaser is prohibited from using borrowed funds for the acquisition of a land use right, but they were unable to clarify whether this is a legal restriction, a limitation imposed by lenders, or simply common practice.

## B. GOVERNMENT SALE OF LAND USE RIGHTS

The process for the government’s sale of a land use right, like so many other procedures in Chinese law, derives from a

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113. *Id.* at 125–26 (emphasizing that most of Chinese landlord-tenant law does not apply to holders of granted land use rights).

114. One Chinese lawyer indicated that this practice has recently been modified, and that some owners have been permitted to pay the fee on a periodic schedule that is similar to regular rent payments. This newer method allows the government to pace its receipt of the income from the sale of the land use right.

115. RANDOLPH & LOU, CREL, *supra* note 10, at 131–32.

116. Law on Admin. of Urban Real Estate, art. 38 (1995) (prohibiting a grantee from further transferring the land use right before “having fulfilled twenty-five percent or more of the total investment for development in the case of housing projects”).

117. ZIMMERMAN, DESKBOOK, *supra* note 39, at 739. In that sense, the Chinese land use right is both similar to and different from the Western ground lease. Because Chinese land can be owned only by the government, the granting of a land use right by definition severs ownership of the land from ownership of the building constructed on that land, just as the Western ground lease does. But in China, the holder of the land use right also must own the building constructed on that land, which forces the developer to incur the capital expense of acquiring the land use right in its entirety at the beginning of the construction process. Law on Admin. of Urban Real Estate, art. 31 (1995). The ground lease, by contrast, permits the developer to avoid all or most up-front land acquisition costs. The Chinese land use right, in short, is not a financing device.

combination of written law and actual practice.<sup>118</sup> Shanghai's procedure serves as a useful illustration of these granting practices.<sup>119</sup> The government initiates the sale process by deciding on requirements and specifications for a tract. It asks the Department of Land Administration to evaluate the property's value, and this administration establishes a minimum price for the land use right. The government then publicizes these requirements and specifications and makes the relevant documents available to prospective bidders. Bidders then submit sealed bids.<sup>120</sup> Each bid from a developer is solely a price bid, as the government already has established all of the specifications in advance.

Shanghai's government is not required to select the highest bidder, a fact that leads unsuccessful bidders to wonder whether they have been outflanked by corrupt competitors and opens the government up to more generalized charges of cronyism and graft. The government's position, publicized regularly and somewhat defensively, is that it wishes to consider the reputation, experience, skill, and financial strength of each bidder, and not just the amount it has bid, as a means of ensuring that the winning bidder is capable of completing the project successfully. While it might appear to the public that the government would benefit the most by selecting the highest bidder and receiving the greatest amount of money for the land use right, the government maintains that a project that is less financially remunerative in the short run but more likely to be completed successfully may end up being more beneficial to the community in the long run.

Despite the municipal government's protestations, prospective bidders who have good personal relationships with highly placed government officials are widely perceived as enjoying an

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118. See Law on Admin. of Urban Real Estate, arts. 11–12 (1995) (describing procedures for granting of land use rights). See also CHEN, INTRODUCTION, *supra* note 24, at 252–53 (discussing the recent historical development of these procedures).

119. A more complex series of steps than the one described here must be followed if the land to be auctioned is agricultural collective land. See *supra* notes 91–92 & accompanying text.

120. Shanghai permits open auctions as well, but these are rarely employed. More generally, land use rights in China may be sold by negotiated agreement, by invitation of tenders by the government, or by auction. ZIMMERMAN, DESKBOOK, *supra* note 39, at 734–35.

For a discussion of regulations promulgated in 2002 that affect the acquisition of land use rights, see T. Oliver Yee, *A Bid For A New Future: What Are the Effects and Challenges of the New National Public Bidding Regulations on Land Use Rights Assignment in China?*, 4 WASH. U. GLOBAL STUD. L. REV. 447, 449–51, 455–57 (2005) (noting that new national regulations, modeled on those already in effect in Shanghai, will no longer permit negotiated agreements for transfers of land use rights for business operations, but also observing that there have been difficulties in implementing these regulations).

edge; whether they truly do or not is almost immaterial to these popular views. These perceptions are further enhanced by a belief that the specifications themselves sometimes seem to have been drafted with particular prospective bidders in mind.<sup>121</sup> In many of the discussions I had with Chinese real estate professionals, concerns that bureaucrats with unfettered discretion favor developers with *guanxi* permeated the conversation. As one lawyer put it, even in Shanghai, it never hurts to know someone.

Whatever its remaining flaws, Shanghai's method of auctioning land use rights has improved dramatically and is generally perceived as having improved. While government officials still enjoy substantial discretion, Shanghai's current approach is a significant advance over the mechanism employed before 2002, under which the municipality would select several reputable developers and negotiate with them privately before choosing one. Some of the less commercialized provinces apparently still negotiate sales of land use rights in this less transparent manner. Imperfect though they may be, Shanghai's present procedures are widely recognized as among the most impartial in China.<sup>122</sup>

The calculation of "minimum price" that the Department of Land Administration undertakes can be a complex one. As a starting point, the floor price should reflect some base value for the land use right itself. But if the government plans to undertake the additional costly tasks of relocating current residents and demolishing existing structures, it will pass the costs of these activities along to the bidders in the form of a higher minimum price.<sup>123</sup> In some cases, the government also factors in a third component, reflecting certain infrastructure costs that the redevelopment of the land will necessitate. For example, the bidder may have to foot the bill for facilities specific to the lot, such as utility connections, or for more general social demands, such as a new hospital that might now be needed as a result of increased construction in the area that includes the new development. This last component of the minimum price for the land use right is roughly analogous to the impact fees that some American jurisdictions impose. Some of these additional components of the minimum price, in particular the cost of demolition and resettle-

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121. Similar concerns are raised by the foreclosure process, which is often seen as providing advantages to favored bidders.

122. See DALI L. YANG, *REMAKING THE CHINESE LEVIATHAN: MARKET TRANSITION AND THE POLITICS OF GOVERNANCE IN CHINA* 208–213 (2004) (discussing trend toward use of auctions in granting of land use rights). See also *id.* at 211 (describing Shanghai and other municipal governments as "hooked on land revenue"). But see *supra* note 53 (noting recent scrutiny of corruption in Shanghai).

123. See *supra* notes 85–86 & accompanying text; *supra* Section V.D.

ment, further illustrate why developers tend to prefer land that is already vacant.<sup>124</sup>

### C. EXPIRATION OF LAND USE RIGHTS

One obvious question about China's current system of land use rights is what happens to the land use right and the structures on the land when the term of the right expires. Since the system of land use rights is less than two decades old while most land use rights are granted for periods of forty or more years, China's legal system and real estate market have had little occasion to address this question. One Chinese lawyer told me that he was aware of a handful of instances in which shorter-term land use rights, granted originally for less than the legal maximum term, had been approaching their expiration dates. While the lawyer stated that the government legally could have recovered possession of the land and the buildings now on the land, he personally knew of cases in which the government either had been willing to negotiate an extension of the land use right or had provided compensation for the buildings.<sup>125</sup>

Given the absence in China of ad valorem property taxes and given the fact that government at all levels will someday run out of desirable land on which to grant new land use rights, it would not be surprising if Chinese government entities were willing to negotiate extensions of land use rights in exchange for the payment of a periodic or one-time fee to the government. The amount of this fee could fall anywhere within a fairly wide range. At the high end, the government could demand that the occupant make an annual payment equal to the fair market rental value of the land at the time of the renegotiation, perhaps with periodic increases built in. If this were to happen, the government essentially would become the landlord of every property occupant in China and would use the proceeds it receives in its

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124. Even if the minimum price for the land use right does not include a component reflecting the economic impact of the development on the community, the developer may end up incurring at least some of these costs anyway in a more direct fashion. For example, the developer may have to install certain utilities itself.

125. Cf. Law on Admin. of Urban Real Estate, art. 21 (1995) (providing that (i) holder of land use right that wishes to extend it must apply for such an extension no later than one year before the right expires; (ii) such applications "shall be approved"; and (iii) land user shall execute a new contract "and pay fees for the granting in accordance with the regulations"). This article of the statute does not clarify what the terms or price of the extension shall be. Professors Randolph and Lou argue that the government must renew, essentially giving the holder of the land use right a right of first refusal, but Article 21 does not specifically state this. RANDOLPH & LOU, CREL, *supra* note 10, at 128-29. One expert suggested to me that a more accurate translation of Article 21 is that these applications "*should* be approved," not "*shall* be approved," which implies a greater level of discretion.

capacity as landlord-to-all to provide government services.<sup>126</sup> Land use rights renewed under such a system would resemble Western ground leases to a greater extent than do current Chinese land use rights, but with the government as ground lessor.

At the low extreme, the government might seek only a small percentage of the value of the land each year, in which case China would have ended up adopting a real property taxation system not unlike that followed in much of the United States. Under this system, current land occupants may retain occupancy indefinitely on the condition that they make regular tax payments to the government in an amount that is far lower than the rental value of the property. The government would have obvious economic incentives for choosing the former method. With either approach, or any approach in between, rather than receiving periodic rent or tax payments, the government might instead prefer to receive all of the proceeds from the rights holder at the outset of the renewal period, essentially treating the renewal of the land use right in the same way it currently treats the initial grant of the right.

#### D. LAND USE RIGHTS, LAND USE CONTROLS, AND FINANCIAL PRESSURE ON THE GOVERNMENT

The Chinese land use right system also ends up functioning as a zoning arrangement. When it announces the availability of land, the government places limits on the uses it will permit, limits that it enforces further in the written document that it executes with the eventual purchaser of the land use right.<sup>127</sup> The establishment and transfer of land use rights is not the only method of land use control in China—and land that is not subject to land use rights is not restricted by these types of controls—but it is one component of an overall land use system. Moreover, the division of land into government-owned land and land owned by agricultural collectives also serves as a rudimentary form of zoning.<sup>128</sup>

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126. See, e.g., Keith McKinnell & Anthony Walker, *China's Land Reform and the Establishment of a Property Market*, in LAND, PROPERTY AND CONSTRUCTION, *supra* note 5, at 33 (comparing mainland China's approach, unfavorably, to that of Hong Kong).

127. See, e.g., RANDOLPH & LOU, CREL, *supra* note 10, at 391–92 (setting forth the provisions regulating land use contained in one of the official forms of contract for granting land use rights on state-owned land).

128. See *supra* notes 91–92 & accompanying text. One expert noted to me that some land owned by agricultural collectives currently is being used for commercial purposes. This land tends to be in areas in which urban growth has raised the value of what once was, but no longer is, outlying farmland. Rather than seeing their land converted from allocated to granted land with the profit going to the local government or the real estate developer, some collectives received permission to build

Note, however, that the price of a land use right is a function of the total buildable area that can be constructed on the land. If that number changes as the building evolves, the price is adjusted accordingly. This fact provides a stark illustration of the tension between regulating land uses and maximizing revenues that local government entities face: A bigger building may be undesirable for land use planning reasons, but it will generate more revenue.

The possibility of profiting from the sale of land use rights creates enormous tensions for local governments, and not only on the lot-by-lot basis just mentioned. Municipal planning bodies may have devised long-term land use programs that restrict certain types of developments in specified areas. At the same time, these municipal governments must glimpse enormous revenue-raising possibilities from the sale of prime, restricted land to a developer who wishes to use it in a way that might not comport with the overall land use plan.<sup>129</sup> Internal and external pressures are growing to place greater emphasis on environmental considerations, and Shanghai officials frequently stress the increasing amount of green space that is available to residents of that city. But if land that is slated for a downtown park proves to be considerably more valuable to its owner—the municipality—than anticipated, the incentive to sell the land use right to a developer will grow correspondingly.

The government can, if it chooses, be fairly heavy-handed in the way in which it uses the land use right system to control patterns of land use. If the government wishes for one area to become, say, a center of international banking, it can decide that it will grant land use rights to international banks only in that area. This approach may be a step less intrusive than forcing those banks to relocate, but it guarantees that when a bank chooses to move, it will have to move into the designated area.<sup>130</sup> As noted earlier, when the government wanted to encourage foreigners to relocate to the Jinqiao section of Pudong, it increased the likelihood of this happening by letting the proprietors of several international schools know that their desire to acquire land use rights would most likely be met should they select locations in Jinqiao.<sup>131</sup>

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commercial structures on their allocated land and now are in a position to pay dividends to the members of the collective. See also RANDOLPH & LOU, CREL, *supra* note 10, at 61 n.8.

129. Compare this problem to the conflict of interest between the central government, which may wish to slow development to a manageable level to keep any real estate bubbles from bursting, and provincial and municipal governments, which profit more directly from each sale of a land use right. See generally *supra* notes 63–72 & accompanying text; *infra* notes 132–33 & accompanying text.

130. See *supra* note 62 & accompanying text.

131. *Id.*

Nearly every expert with whom I met concurred that provincial and municipal governments employ the sale of land use rights as an essential means of keeping themselves afloat financially.<sup>132</sup> The Chinese real estate bubble has made these rights quite valuable in some parts of the country, and government bodies in these regions appear to treat land use rights as cash cows to be milked as the need arises. Of course, these government entities must recognize that if they sell this land off too rapidly, they will distort both their own long-term financial viability and the overall real estate market.<sup>133</sup> Short-term needs, however, often tend to trump longer term ideals. There is a great deal of tension between the ongoing proclivity of municipalities and provinces to raise needed funds by selling off land use rights and the primary objective of the central government, which is to maintain overall social stability on a nationwide basis. Beijing, in short, perceives far greater reasons to slow the real estate market down and suffers the least when it succeeds in doing so.

## VII. CONCLUSION

China's recent modernization of its cities would be remarkable if all it had done was spend tremendous sums of money to replace crumbling buildings and infrastructure. The fact that China has accomplished these feats despite its prohibition on the private ownership of land, its stated adherence to Marxist principles, and its absence of a national property law makes these successes even more incredible. By allowing state-owned land to be controlled by private parties for extended time periods, China has ignited its private sector, which has been willing to gamble that the nation's legal development will eventually catch up to its economic growth. So far, the private sector has not been disappointed, but the job of law reform is nowhere near complete.

Other features of the Chinese real estate market also demand further maturation. The mortgage industry still is in its infancy. Construction disputes plague many real estate development projects. Government manipulation of interest rates and transfer tax rates suggests that the Chinese market is not as free and open as the Chinese leadership would like outsiders to believe. I plan to examine these and other issues in subsequent articles.

China's rulers seem to want to rebuild an entire country in just a few decades. Considering that they began this task recently and that the starting point was an economy that had been

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132. See *supra* notes 63–72 & accompanying text, note 129 & accompanying text.

133. Cf. *supra* note 103 (comparing China's approach with that employed by Russia following the disintegration of the Soviet Union).

stagnant for half a century, China has made noteworthy progress. For the interested observer of contemporary real estate markets, China is the most fascinating place in the world, and the coming years promise to be no less exciting.